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AIRLINE COMPETITION

HEARING

BEFORE THE

SUBCOMMITTEE ON AVIATION

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

AIRLINE COMPETITION

SEPTEMBER 20, 1989

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AIRLINE COMPETITION

WEDNESDAY, SEPTEMBER 20, 1989

U.S. Senate,
Committee on Commerce, Science, and Transportation,
Subcommittee on Aviation,
Washington, DC.

The subcommittee met at 9:30 a.m., in room SR-253, Russell Senate Office Building, Hon. Wendell H. Ford (chairman of the subcommittee) presiding.

Staff members assigned to this hearing: Steve Palmer, senior professional staff member; Carol Carmody, professional staff member; and John Timmons, minority staff counsel.

OPENING STATEMENT BY SENATOR FORD

Senator **Ford**. Good morning, ladies and gentlemen.

I am pleased to bring to order today's Aviation Subcommittee hearing on airline competition and the barriers to entry that limit competition among airlines in this country. This is an important issue for the aviation community as well as this subcommittee.

I can say that with certainty, because I have firsthand experience with how the lack of competition can adversely affect airline affairs. Very simply, in the last 10 years, the price I pay for my ticket to Kentucky has gone up 400 percent. And even though I am chairman of the Aviation Subcommittee, I do not have a choice in the flights. If I do not fly with one airline, I am out of luck.

With that in mind, I am particularly pleased that we have before us today two federal agencies responsible for protecting the traveling public. The Departments of Transportation and Justice wield enormous administrative and enforcement powers in shaping the competitive state of the airline industry. As such, it is critical that we have an understanding of what policy-makers at these agencies are thinking when they exercise authority that will affect over 450 million passengers.

In that regard, I joined Senators Hollings, Danforth and McCain earlier this year in writing to Secretary Skinner and Attorney General Thornburgh to solicit their views on a number of policy issues critical to the aviation industry. These letters sought to explore the views of federal regulators on not only what could, but what should be done to ensure the revitalization of airline competition.

I hope to discuss these questions further with our witnesses today, focusing on what actions they plan to take to eliminate current industry barriers to entry and competition.

I also look forward to testimony from the General Accounting Office on its ongoing study into these barriers to entry. The GAO has done outstanding work for this committee on the issue of airline concentration over the past year, and I look forward to hearing the results of their research work, as well as their suggestions for policy changes that will enhance the level of competition.

It is our responsibility on the Aviation Subcommittee to ensure that our aviation system, which has become the closest thing to mass transportation that we have today, provides quality service at affordable prices.

And I would say to all in the audience today that that is my goal, and I intend to do all I can to ensure its fulfillment.

I am pleased that the ranking member, Senator McCain, is here today.

Senator, do you have any comments?

OPENING STATEMENT BY SENATOR McCAIN

Senator McCain. Thank you, Mr. Chairman.

First, I would like to take a moment to recognize your leadership on the issue before us. Your efforts in investigating the problems in airline competition and in helping find the solutions are truly appreciated

I would like to thank you and Senator Danforth, who is our distinguished ranking member. I do not believe that we could have successfully addressed some of these problems without your leadership and in-depth knowledge on these issues.

Mr. Chairman, I believe my position on the issue is clear. The evidence I have seen leads me to conclude that action must be taken if we are to avoid a return to de facto re-regulation.

The GAO has submitted to this committee numerous studies demonstrating that where concentration exists and competition lags, the airline consumer pays more for an equivalent product than at a truly competitive airport. An objective reading of information submitted to the committee by the Departments of Transportation, and by the airlines' own trade association, the Air Transport Association, buttresses these findings.

Today, Mr. Chairman, we will receive from the GAO the results of their work on identifying barriers to entry in the airline business, both in terms of new airlines and airlines offering new service. We will also receive their recommendations on what actions we could or should take to improve the competitive atmosphere in commercial aviation.

I also welcome representatives from the Departments of Justice and Transportation, who hopefully will enlighten us on the views of the Bush Administration in the area of airline concentration.

I believe it is appropriate that they appear before us at the same time we receive GAO's recommendations. We find ourselves in this state of affairs in large part because of decisions made by the previous administration. I do not mean to be critical of them. Most of these decisions were made in good faith, based on assumptions that, as we see now, were incorrect.

We all have 20/20 hindsight, so I am not interested in assigning blame; I am interested in devising solutions.

When discounted coach fares on the country's 20 most travelled routes rise an average 26 percent over 1988 and the first quarter of

1989, and business discount fares on the same routes over the same period of time increase 47 percent, we obviously have a competition problem. This problem will be solved only by cooperation between Congress and the Administration. I hope this cooperation will be forthcoming.

Mr. Chairman, I strongly believe that we must be careful that we do not create solutions which result in a condition worse than that which we are trying to fix. And at the same time, we cannot let tough choices deter us from acting.

I would welcome and encourage my friends in the airline business to help this Committee in whatever way they can. One area that I feel strongly about is that we should seriously consider legislation forcing divestiture of the CRS from the airline industry.

I believe that GAO will tell us that the CRSs are one of the factors which basically serve as a profound and deep impediment to fair and equal competition within the industry.

Mr. Chairman, I look forward to the testimony today and working with you to fashion appropriate solutions to the problems that have been identified in our efforts.

Thank you, Mr. Chairman.

Senator FORD. I thank my friend, and let me thank him also for his kind words. But I say to him, this has been a team effort and we have worked together. And I have been grateful for his support and cooperation.

We have been joined by the distinguished senior Senator from Alaska, Mr. Stevens. Do you have any comment you would like to make before we start the hearing?

OPENING STATEMENT BY SENATOR STEVENS

Senator STEVENS. Well, I am on my way to another hearing, but I wanted to stop by and encourage this team to keep it up. I am out on the end of the tentacles of this system and I am seeing the system deteriorate.

As a matter of fact, it now costs more to go round trip to Seattle from Anchorage than it costs to go round trip from Seattle to Washington, D.C.

And I think that we are seeing some real disparities in the total cost to the consumer. I am beginning to think maybe what we ought to do is require that the airlines deliver to the purchaser of the tickets all alternative rate structures that are available.

In other words, if you are going to buy a ticket from one airline, that the system ought to tell the consumer that if you bought a ticket from another airline, you would have an entirely different rate structure; or if you went through one stop on the way from Seattle to Washington, the cost would be so much less. There seems to be a premium now for non-stop service, and I do not think that is being disclosed.

I am getting increasing complaints from people who say that they make a trip and then, when they come back, they compare the costs of that trip with someone else who has made a similar trip on another airline and found out that, with a little bit of change in the route and very little change in the time consumed, the cost was considerably different. Or if they had purchased a ticket even a day sooner, they would have had an entirely different rate base for their trip.

And I want to encourage this team to keep it up. I state categorically, as one of those who supported the whole concept of deregulation, that I am looking very strongly at re-regulation. And I am having some bills drafted now to restore regulation. Because our people just cannot survive this.

If this keeps up, my state will be totally isolated from the other 50. And I have got to tell you, I do not like that one little bit. And I think it costs our people an excessive amount to use a system where the seat-passenger-mile density is no different from any other place in the country.

And there seems to be some discriminatory pattern developing on a season basis, I might add. In the summertime it costs more to go to the sun country, and in the wintertime it costs more to go into the winter country.

And maybe it does cost more to operate there, but I would like to see that justified. I would like to see it justified to the people who ought to have some oversight of this deregulated industry, and it ought to be more responsive to consumer demand.

Thank you very much, gentlemen. Keep it up.

Senator FORD. Thank you very much, Senator. I can attest to that. My son left the hometown on the same airline that I come to Washington on. He paid half the price to go to Los Angeles that it cost me to have a round-trip to Washington. So, yes, I understand it vividly. And when you get in my hip pocket, I understand it very severely.

Senator Bryan, we are delighted to have you here with us today. If you have a statement, we are perfectly willing to listen to you.

OPENING STATEMENT BY SENATOR BRYAN

Senator BRYAN. Mr. Chairman, I appreciate that. I would like to ask that a statement that I have be made a part of the record.

Mr. Chairman, I commend you for holding hearings on airline competition. We all recognize that the airline industry plays an increasingly important role in today's economy.

In my home state of Nevada, the airlines play a particularly significant role in support of our tourism industry. Safe, reliable and fairly priced airline service is critical not only to Nevada passengers, but also to the millions of Americans who use the airlines to visit Nevada. More than 50% of the visitors to our state travel by air.

The airline industry has undergone considerable change in the decade since Congress passed the Airline Deregulation Act of 1978. The central goal of this Act was to assure safe and low-price airline service by placing "maximum reliance on competitive market forces."

Mr. Chairman, I must say that I sincerely doubt—and I believe a great majority of the of the American public doubts—that we got what we bargained for. First, there is no competition on many routes resulting in extraordinarily high fares for those passengers. Second, the effect of deregulation has been uneven: although some communities may have benefitted, I am concerned that many small and medium size cities have been adversely impacted. In addition, our rural communities are continually in jeopardy of completely losing their air service. Finally, and most important, we must be continual mindful of the critical need to ensure the utmost safety of the flying public.

Monopoly Routes: A central premise of deregulation was that competition would ensure low prices. Indeed, immediately after deregulation went into effect, we saw the forces of competition unleashed: competitive service and low fares were found in abundance. Then carriers began to withdraw when competition was too fierce. Airlines established hubs, or minihubs, and began to protect a market niche. The more entrenched a carrier became, the less a new carrier—or even an established carrier—has been willing to challenge the dominant airline.

The result has been that many routes are now served by only one carrier. And passengers on those routes are paying fares considerably higher than the fares on the competitive routes.

And even where there is competition, the fare structure is often incomprehensible. Throughout the country, customers have been treated to advertised fares which—when available—have brought airline travel within the reach of a vast number of Americans. However, when an individual needs an airline most—to attend a family funeral, to attend to a sick relative, or for other countless emergencies—the low fares are unavailable. Indeed, often the only available fare is considerably higher—often 3-4 times more—than the low advertised fare.

Effect on Small and Medium Size Communities: I am particularly concerned about the effect of deregulation on small and medium sized communities. I have asked, together with a number of other Senators, for a Government Accounting Office (GAO) analysis of the fare structure at these cities. I anticipate that the study, which is expected in the fall, will show what many of us already know—that service has decreased and fares have increased for the residents of many of our smaller communities.

Essential Air Service: Finally, Congress has also recognized the threat deregulation poses to our rural communities. Through the Essential Air Service program, Congress has worked to assure that service will be continued to these communities when airlines do not find it profitable to do so. However, given budgetary constraints, even the modest Essential Air Service program is under continuous attack threatening service to the American communities.

Finally, and most important, we must be continual mindful of the safety of the flying public. We need to assure that aircraft being flown—no matter what price one pays for a seat—is safe and well-maintained. No amount of competitive pressure should cause an airline to compromise the safety of its passengers.

Mr. Chairman, I believe we need to carefully examine the effect deregulation has had on airline service in this country *and* on airline service in individual communities throughout the country. I look forward to these hearings and to working with you to assure that this country has safe, reliable, and fairly priced public air service.

I would just like to compliment the gentlemen before us. I think for a State that is as dependent upon air service as Nevada, with the confusion that reigns within the airline industry, in terms of the number of options and the frequency with which those options change, it seems to me that today even the sophisticated traveller needs a Rosetta Stone to guide you through the various options. For that reason I have a number of concerns which I would like to have addressed in a set of questions for the panel, Mr. Chairman, with your indulgence.

Thank you so much.

Senator **Ford**. Thank you very much, Senator Bryan.

I have an opening statement that Senator Kasten would like to have included in the record.

[The statement follows:]

OPENING STATEMENT BY SENATOR KASTEN

Mr. Chairman, I am pleased that we are today holding the third in a series of hearings on the causes and effects of concentration in the airline industry.

As many of us have stated at the prior hearings, deregulation has been a boon to the traveling public in general, with more people able to fly than ever before. Competition was to be the primary economic regulator under deregulation, with the government continuing its important role in the safety area. The problem of concentration and its effects focuses on whether competition exists to fulfill its function at the high concentration airports.

I look forward to the testimony of the GAO outlining problems in such areas as the slot controls as hindering competition at controlled airports. I have some problems with this area and Senator McCain and I have been working to have a new rulemaking undertaken by DOT. I understand that is forthcoming in the near term, but unfortunately we have heard this several times before. I'm hopeful that this time we shall see a viable rule proposed by DOT in this area.

I look forward to hearing more about the problems with the computer reservation systems, gate access, and the other subjects to be addressed by our witnesses as we finish our look into this area.

Senator **Ford**. We now have as our first witness, Kenneth M. Mead, Director of Transportation Issues at the General Accounting Office, accompanied by Mr. James Noel and John V. Wells.

STATEMENT OF KENNETH M. MEAD, DIRECTOR, TRANSPORTATION ISSUES, GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY JAMES NOEL; AND JOHN V. WELLS

Mr. **Mead**. Mr. Chairman and members of the Subcommittee, thank you. We appreciate the opportunity to testify on our ongoing work on the status of competition in the airline industry.

Before summarizing what is a rather lengthy statement, I would like to just recognize the staffs of both the majority and the minority in pursuing this entire competition issue. They have been extraordinarily helpful to us.

Also, I would like to acknowledge the people on our GAO team that are not at the table today—Frank Mulvey, Tom Noone, Amy Abramowitz, Steve Brown, Dolores Parrett and Fran Featherston.

Mr. Wells, on my left, directed our barriers to entry work. On my right is James Noel. He directs all of our work in the consumer protection and competition area across all of the transportation modes.

To have a competitive industry there must be ready access to airports and airline route markets by firms that want to offer service.

Our testimony today is based on a broad-based data-gathering effort that is designed to assess the extent to which airports are accessible to entrants and whether some airline marketing practices would inhibit entry.

We will be discussing essentially two types of barriers to competition, or barriers to entry if you will. The first category we refer to as physical barriers to entry, such as access to gates. The second category are airline marketing strategies such as CRSs, frequent flyer programs, and volume incentives that the airlines offer the travel agents.

We surveyed 185 airports around the Nation, including all 66 large and medium-sized airports, to learn about the availability of gates for potential entrants, restrictions on airport expansion, and noise regulations that might affect entry. Our survey gave us a response rate of about 99 percent. We analyzed trends in slot transactions to determine if firms that want to serve the slot-controlled airports in fact are able to secure slots. We also surveyed a cross-section of travel agents to learn whether certain airline marketing practices could create barriers to entry, and finally we have developed an econometric model of the industry to estimate how these potential obstacles to market entry can affect airline fares. The econometric model results are not in yet. We will be getting those in later this fall.

Although our focus is on how certain conditions and practices can make it more difficult for firms to enter markets, it should be recognized that some of the barriers we will discuss today have positive effects as well.

A quick example: restrictions on landings at some airports to control noise may in fact limit entry, but they also benefit the airport's residential and commercial neighbors. Therefore, any evaluation of the factors that can result in barriers to entry must also take the associated benefits into account.

Overall, our work shows that essential facilities at airports may not be readily available on competitive terms to potential entrants and that some airline marketing strategies can in fact discourage market entry. Let me summarize our principal findings.

Gate leases: our airport survey revealed that exclusive-use gate leases give effective control over gates to the incumbent airlines and allow them to keep potential entrants from providing competitive service using the existing gates.

Over half of the 185 airports we surveyed and more than 75 percent of all large airports lease their gates, if at all, on an exclusive use basis, and many of these leases are not short-term, they are of very long-term duration—of up to 20 to 30 years.

Potential new carriers often must sublease gates from an incumbent carrier, and sublease rates are generally at least 10 percent above the cost of leasing the gate directly from the airport. Airline officials told us that sublease rates sometimes are for considerably more than 10 percent.

Also, at 55 of the airports in our survey, including more than 50 percent of the 27 largest airports and 11 of the 15 concentrated airports that we testified before you in June on, there are in place so-called contractual majority-in-interest clauses in gate leases, and these give the incumbent airlines virtual veto power over airport expansion. In fact, at 14 airports, just one airline can use its majority-in-interest to veto airport expansion.

Noise restrictions: noise restrictions, while certainly beneficial to the environment, require the use of newer more expensive aircraft and can make it more costly for new entrants to serve particular airports. Our survey found that the most serious restrictions on noise occur at two airports that operate under court orders that effectively prohibit new entry altogether to control noise.

Seven other airports have established what is called a noise budget, or cap. At some of these, the potential entrants must buy the noise rights from incumbents who may be unwilling to sell.

Slots: our analysis of transactions under the FAA's 1986 buy-sell rule on takeoff and landing slots at four congested airports—and there are only four where the slots are in place: La Guardia, JFK, Washington National, and O'Hare—leads us to conclude that the market for slots is not working as intended.

The major airlines have accumulated slots in excess of their present needs and are leasing out those that they are not currently using, rather than selling them. The buy-sell rule's purpose was to open access to slots to new entrants, but not a single carrier has been able to establish new service at a slot-controlled airport by purchasing slots.

Leasing allows the owner to ensure that the user will not be a direct competitor. Further, over 70 percent of the leases have been for 90 days or less. Such short leases give little assurance that a long-term investment in service will be worthwhile.

We also found that sales between unrelated carriers have fallen from 110 per quarter in 1986 to 28 per quarter in 1987, to 12 per quarter in 1988. One airline that has sought to buy slots, especially in the National and the La Guardia airport markets, reported that most slot owners are not even willing to discuss selling slots and that those who are will not consider selling a slot for less than $1 million per slot. This airline thinks it could not enter the market profitably at these prices.

In addition to capacity constraints, a number of airline marketing practices are also potential entry barriers. Airline-owned computer reservation systems raise the sales costs of those airlines that do not own CRSs relative to those that do. That fact can no longer genuinely be in dispute.

Airlines must pay booking fees for each seat booked by a travel agent using an airline-owned CRS. In addition, travel agents tend to favor the flights of the airline that owns the CRS the agents use, and that limits the available market for a potential entrant.

Finally, restrictive provisions in contracts between CRS vendors and travel agents make it virtually impossible for new airlines to start their own CRS.

Frequent flyer plans: our analysis of frequent flyer plans in our interviews with travel agents suggests that frequent flyer plans, while extremely popular with business travelers, also represent a potential barrier to a new entry.

Three-fourths of the travel agents we surveyed told us that their business travelers choose their flights on the basis of their frequent flyer plans more than half the time. Our analysis of frequent flyer plans shows that they encourage passengers to concentrate their travel on one airline.

The more you travel on that airline, if you're a member of their frequent flyer program, the greater the inducement becomes to stay on that frequent flyer program. Also, many of the frequent flyer programs have deadlines on the use of mileage, so that travelers must accumulate mileage quickly to earn the desired award.

While a new carrier can also offer a frequent flyer plan, the dominant carrier at an airport will offer their traveler more opportunities to accumulate miles quicker and to more destinations.

Volume incentives: most agents we interviewed said the airlines provide them various forms of volume incentives, such as overbooking privileges or travel agent commission overrides, which are euphemistically known as TACOS—travel agent commission overrides.

Overrides are bonus commissions that airlines offer as an incentive for booking more flights. Most of the agents receiving overrides said they were an important part of the agency's overall revenues.

The travel agents also told us that passengers, especially nonbusiness travelers, often leave the choice of the airline to the travel agent.

Now, the agents told us that the most important considerations for making these choices were, of course, fares and passenger convenience. Several said that they based their choice of a preferred airline on which airline provided commission overrides or overbooking privileges.

In a recent report, DOT concluded that commission overrides significantly increase the number of tickets that an agent will book on a particular airline. However, the evidence that is available to us at this time suggests that it is just not clear whether TACOS constitute a substantial barrier to entry.

Code-sharing: another potential entry barrier is code-sharing. This is an agreement between a jet carrier and a commuter carrier to share a common two-letter airline code so that the connecting flights will be booked as though they were on a single airline.

Some industry officials told us that code-sharing can be a barrier to entry because it discourages the commuter airlines from providing interline traffic to carriers other than their code-sharing partners. This problem is worsened, some airlines said, by the fact that the computer reservation services give preference to code-shared connections over interline connections in ranking flights on the CRS screen.

However, the travel agents we surveyed said that travelers prefer code-shared flights because they believe they are more convenient, and they cited such reasons as more reliable baggage handling and more convenient gate locations.

We recognize that this Committee is considering taking action to enhance competition by addressing some of the practices we have discussed. Now, during the course of our work various policy options were identified or surfaced. Though not an exhaustive list, our preliminary evaluations suggest that they can provide a framework for analysis and deliberation.

Again, all of these options involve important policy considerations and require a careful weighing of cost and in some cases benefits, and an assessment of the tradeoffs.

Gate access: one policy option would be to impose Federal restrictions on leases to reduce the long-term control that leasing airlines acquire over airport facilities. Preferential-use leases, as opposed to exclusive-use leases, would give a leasing airline access to the gate when it needs it while still making the gate available to others when it is unused.

Another option would be to repeal the Federal prohibition on passenger facility charges. Passenger facility charges could help solve at least some of the funding problems that have prevented airport expansion, and this would reduce the airport's need to rely on or sign majority-in-interest clauses with the airlines.

You see, the majority-in-interest clause gives the airport and the airport's lender some assurance that there's going to be somebody there to provide airline service over the long haul.

Noise restrictions: some airports, like Boston and Denver, have adopted noise rules which allow waivers to ease entry while still achieving the desired level of noise reduction. Exploration of such noise control strategies might identify other approaches that would allow airports to control noise while minimizing adverse effects on competition.

Slot restrictions: in our view, the current buy-sell rule for airport slots does not allow new entry into slot-controlled markets. One solution would be for the FAA to lease slots to the airlines and eliminate slot ownership altogether. Leasing would not only open up the slot market to new entrants, it could also generate revenue for the Federal Government.

Another alternative for dealing with slots would be for the Department of Transportation, under the provisions of its current rule, to periodically withdraw some slots and reallocate them by lottery.

Computerized reservation systems: in our testimony last year, we discussed a number of policy options ranging from divestiture of airline-owned CRSs to modifications in vendor contracts with travel agents.

We reiterate that action in one area, such as reducing or eliminating booking fees, could create problems in another area, like increases in CRS subscription fees to travel agents. Consequently, agents' bargaining power with vendors would have to be increased by modifying present restrictive contract provisions.

While our written statement notes that DOT has not yet opened a rule-making on CRSs, we would like to acknowledge the advance notice of proposed rulemaking which DOT issued last Thursday, noting the GAO's work in the area.

Other airline marketing practices. The other airline marketing practices—frequent flyer plans, commission overrides, code-sharing—are all subject to regulation by DOT. Should anticompetitive effects be demonstrated, these practices could be either prohibited or modified in some way to reduce anticompetitive effects, but the popularity of frequent flyer plans may make action to reduce their anticompetitive effects simply not palatable.

For example, one modification, short of outright prohibition, would be to require that mileage be transferable from one plan to another, or from one passenger to another. The consumers would certainly like that, and that would reduce the potential for anticompetitive effects because passengers could earn valuable miles on any airline.

Such a requirement would make the plan so unattractive to the airlines that we think there would be a substantial probability that they would withdraw them.

If commission overrides were prohibited, airlines might well resort to other kinds of innovative volume incentives, and if code-sharing agreements were prohibited, airlines might just buy out their code-sharing partners or develop commuter subsidiaries, as several have already done.

Prohibiting CRSs from listing code-shared and on-line connections ahead of interline connections, as the European CRS rules propose, would also reduce their advantage.

Our analysis is not yet complete. The work we have done so far indicates that some features of airline markets are likely to discourage entry. The factors which appear to us most likely to discourage entry are slot controls, CRSs and gate access problems, with the evidence currently available to us on code-sharing and volume incentives being either ambiguous or less compelling.

As we obtain further results from our econometric model this fall, we will be able to provide the Committee with more information on the relative significance of these factors.

Mr. Chairman, that concludes my testimony.

[The statement follows:]

STATEMENT OF KENNETH M. MEAD, DIRECTOR, TRANSPORTATION ISSUES RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, GAO

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify on our on-going work on the status of competition in the airline industry. The deregulation of the airline industry was predicated on the belief that low fares and good service would be ensured because the industry was inherently competitive. Proponents of deregulation believed that competition would thrive because it would be relatively easy for new firms to enter the industry or for existing firms to expand into new markets. The success of deregulation depends in large measure on minimizing the barriers to new entry that can result when existing firms take actions that raise the potential entrants' costs or erect other obstacles that bar entry entirely.

At the request of Senator Danforth, Ranking Minority Member of the Committee on Commerce, Science, and Transportation, and also at the request of the Chairman of the House Committee on the Judiciary, we are examining how changes in airline operating and marketing practices might discourage new or existing carriers from entering new markets.

Our testimony today is based on a broad data-gathering effort designed to assess the extent to which airports are accessible to entrants and the likelihood that airline marketing practices would affect entry. To determine the extent to which essential facilities at airports are available for use by entrants, we conducted an extensive survey of 185 airports, which has yielded detailed data on gate leases, restrictions on expansion, and noise regulations, which might affect market entry. To determine the effects of the Federal Aviation Administration's (FAA) buy/sell rule for slots, which restricts landings and take-offs at four congested airports, we analyzed trends in slot transactions at the four airports and their impact on entry since the rule went into effect in April 1986. Finally, to determine how airline marketing practices affect travelers' airline choices, we surveyed a cross section of travel agents. The final part of our work--an econometric model of the industry to estimate the effect of these practices on airline fares--has been developed and estimation of the model has begun.

Although our focus is on barriers to market entry and how these barriers might affect airline fares, some of these barriers can have positive effects as well. For example, restrictions on landings at some airports to control noise can prevent entry, but also benefit the airport's residential and commercial neighbors. Similarly, airline-owned computerized reservation systems, known as CRSs, may raise the cost of competing with a CRS vendor airline, but reduce the cost of marketing airline tickets. Any assessment of practices that result in possible barriers to competition must therefore consider not only costs, but possible benefits as well.

Overall, our work on airline competition to date shows that essential facilities at airports are often not readily available on competitive terms to entrants, and that some airline marketing strategies can discourage market entry. Some factors are likely to have a greater impact than others, and some have benefits as well as costs. Specifically, we found the following:

-- Exclusive-use gate leases give effective control over gates to the incumbent airlines and enable them to prevent entrants from providing competitive new service using existing gates. Contractual clauses in some airport general use agreements give the incumbent airlines the power to prevent the airport from constructing new gates. These provisions do have the benefit of reducing interest costs for airports and allowing incumbent airlines to plan their service offerings with greater assurance about the availability of gate space. Our survey found the use of these provisions to be widespread.

-- Noise restrictions are important in reducing the environmental costs that airports impose on their neighbors. However, our survey showed that these restrictions effectively bar entry at two airports and raise the cost of entry at several others.

-- Airport take-off and landing "slots," which are needed to gain entry at the four airports covered by FAA's high-density rule, have not been readily available for new entrants. The high-density rule is intended to prevent congestion and to help maintain safe access to these four airports. However, our analysis showed that under the present system no airlines seeking to start service at these airports have been able to buy slots, and the number of slots sold has steadily declined. Short-term leases of slots, which allow the owner of a slot to prevent entry by potential competitors, have become more common.

-- Airline-owned CRSs provide a valuable distribution tool for travel agents and airline passengers. However, CRSs artificially raise the costs of participating carriers, making it more difficult for non-CRS-owning carriers to compete in markets against an airline whose CRS is widely used by travel agents.

-- Frequent flyer plans are popular bonuses with airline passengers, and according to the travel agents in our survey, business flyers often choose their flights on the basis of their frequent flyer plans. Our analysis indicates that the dominant carrier at an airport has an intrinsic advantage in attracting passengers to its frequent flyer plan. These plans therefore give the dominant carrier an advantage over other carriers and could discourage new entry.

-- Travel agent commission overrides, known as TACOs, are bonus commissions that airlines pay to travel agents on top of their regular commissions as an incentive for the agents to book more flights on those airlines. Most of the travel agents we spoke with said that the airlines pay them TACOs, which the agents describe as making an important contribution to agency profits. TACOs appear to influence the share of tickets sold by an agent on the airline paying the TACOs, but may not offer an incumbent airline any clear advantage over a new entrant.

-- Code-sharing is an agreement between a jet carrier and a commuter carrier to share a common 2-letter airline code, so that connecting flights between the two airlines are booked as if they were on a single airline. Our survey of travel agents indicated that, among those passengers who expressed a preference, most preferred code-sharing connections over connections between two flights of different airlines, though some of the airlines we talked to said that code-sharing may make market entry difficult for non-code-sharing airlines.

Our analysis of airline market competition indicates that some government and industry practices can reduce competition by discouraging market entry. Some, such as slot restrictions and gate leases, restrict access to facilities that are essential for entry. Others, such as CRSs and frequent flyer plans, have characteristics that could disadvantage entrants and discourage competition. Finally, some industry practices, such as TACOs and code-sharing, seem less likely to disadvantage entrants or have more compelling compensating advantages for consumers. While we do not yet have definite estimates from our econometric model of the impacts of these industry features, we believe that some are likely to restrict entry and inhibit competition.

Given these findings, the Congress and the Department of Transportation (DOT) may wish to begin reviewing policy options for reducing the anticompetitive potential of some of these practices while retaining most of their beneficial effects. In the remainder of our statement, we will review the development of a deregulated airline industry; discuss the data sources we have used to analyze barriers to competition; discuss our findings on airport capacity, slot restrictions, and airline marketing strategies; and review possible policy options for minimizing the impact of entry barriers.

BACKGROUND

In 1978, the Congress passed the Airline Deregulation Act, which provided for the gradual deregulation of the airline industry, culminating in the "sunsetting" of the Civil Aeronautics Board (CAB) at the end of 1984. CAB's authority to set fares and to control which carriers served which routes was eliminated. The deregulation of the airline industry was predicated on the belief that the industry was inherently competitive, and that the potential for easy entry by new carriers in a market would apply enough competitive pressure on incumbent airlines in that market to keep fares low and service high.

Indeed, in the early years after deregulation, many new carriers did enter the industry, and many existing carriers entered new markets. Most of the new carriers were small regional carriers, but several competed effectively as jet carriers. After 1985, however, the rate of entry declined and most of the new entrants went bankrupt or were absorbed in mergers.

In the early years of deregulation, the major airlines all adopted "hub-and-spoke" networks, which concentrated the operations of each airline at a handful of "hub" airports. Airlines also adopted several new marketing strategies, such as frequent flyer plans, TACOs, code-sharing, and more widespread use of CRSs. Hub-

and-spoke routings, code-sharing, and CRSs provided benefits by reducing the cost of providing service and permitting increased flight frequencies. However, they also raised concerns about increased market power. These changes led some observers to wonder whether entry into airline markets was still as easy as had once been believed.

Objectives, Scope, and Methodology

We have examined two categories of factors that may reduce competition by discouraging entry. One category includes restrictions on capacity and operating authority at airports. These include potential problems in getting access to gates and other physical facilities at the airport; in offering service because of noise restrictions; and in securing slots at the four slot-controlled airports. The other category includes airline marketing strategies that may increase the difficulty of entry into new markets. These strategies include airline ownership of CRSs; frequent flyer plans; TACOs and other volume incentives offered to travel agents; and code-sharing agreements between jet carriers and commuter airlines.

To assess the extent of restrictions on capacity at airports, we sent out an extensive survey to 185 airports.[1] We received responses from 183 airports, including all 66 large and medium-sized airports, for a response rate of 99 percent.[2] The survey asked the airports to report which airlines leased their gates, ticket counters, baggage carrousels, and other facilities, and the terms on which those facilities were leased. It also asked about the potential for expanding the airport's capacity, about financing for capacity expansion, and about contractual clauses in leases that may restrict expansion. Finally, it asked about noise restrictions that may reduce entrants' access to the airport.

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[1] Actually, we sent the survey to 187 airports. However, two of these responded that they had no scheduled passenger service, so they were dropped from the sample. Our sample included all the large and medium hub airports and a stratified sample of smaller airports.

[2] DOT classifies airports as large hubs if they handle 1 percent or more of the nation's total revenue passenger enplanements. Medium hubs are those handling between 0.25 percent and 0.99 percent. DOT identifies 71 large and medium-sized airports, but we included only those in the 48 contiguous states.

To assess the impact of FAA's "buy-sell" rule for airport take-off and landing slots, we analyzed data from the FAA's Slot Administration Office on transactions that have taken place since the rule went into effect in April 1986. This rule allows the slots allocated under the FAA's high-density rule to be bought, sold, and leased. We identified trends in sales and leases of air carrier and commuter slots by different airline types at each of the four slot-controlled airports.

To assess the likely impact of airline marketing strategies on the booking of airline flights by travel agents and their customers, we conducted a series of structured interviews with a stratified random sample, designed to represent various geographical and revenue categories, of 32 travel agencies. We also examined the provisions of frequent flyer plans, interviewed representatives of large and small airlines, and reviewed a wide range of studies of airline competition.

Finally, we have developed an econometric model of the airline industry to analyze the effects of industry practices and structural features on airline fares.

AIRPORT CAPACITY IS LIMITED BY LEASE RESTRICTIONS AND NOISE RULES

An airline wishing to establish competing service at an airport needs access to a gate. It also needs access to other physical facilities, such as hold rooms, ticket counters, and baggage carrousels. If the entering airline cannot get access to these facilities at a competitive cost, entry can be impeded and competition reduced. To assess the extent to which gates are available for use by entrants who wish to establish competing service at an airport, we surveyed 185 airports and asked them about the terms under which their gates and other physical facilities were leased.

Our survey found that gates are often leased under provisions that give some degree of control over the gate to the leasing airline, either because the gate is for the airline's exclusive use, or because the lease is for a long period of time, or both. To the extent that gates are leased on these terms, it will be more difficult for airlines wishing to establish new competing service at an airport to gain access to the gates needed to establish service. Moreover, the provisions of some airport leases give the airlines control over the construction of new gates, as well as over the use of existing gates. These provisions are called "majority-in-interest" clauses.

Exclusive-use leases

Most airport gates at large and medium-sized airports are leased to major airlines on a long-term, exclusive-use basis.[3] Half of all airports, and more than three-quarters of large airports, lease all their gates on an exclusive-use basis. Many of these gates are leased on very long-term agreements of up to 20 to 30 years duration, with some not expiring until the 21st century. Eighty-three percent of all leased gates are on leases that will not expire for more than 2 years, and 54 percent will not expire for more than 10 years.

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[3] The Department of Justice focuses on a two-year time period for purposes of assessing ease of entry into a market in its U.S. Department of Justice Merger Guidelines (Section 3.3, p. 28) dated June 14, 1984. Therefore, we considered any lease of more than two years to be long-term.

When gates are leased on an exclusive-use basis, carriers wishing to establish new service at the airport can gain access to those gates only by subleasing them from the leasing carrier. According to airport officials, gates are normally subleased for at least 10 percent more than the cost of leasing the gate directly from the airport. Airline officials told us that sublease rates sometimes are for considerably more than 10 percent over the basic lease rate. Such rates would put a subleasing airline at a competitive disadvantage to the airline that leases the gates directly from the airport.

In other cases, according to officials of airlines that have sought to sublease gates, leasing airlines have refused to sublease gates, but instead have offered the entrant a "handling" contract, under which the leasing airline provides personnel to staff the gate as well as the physical space. In some cases, one airline official told us, these contracts increase the costs of the entrant by as much as four times over the cost of servicing the flight with its own personnel. Airports receiving federal grants for development projects must provide the Secretary of Transportation with assurances that subtenants are charged reasonable rent and that each carrier serving the airport has the right to handle its own planes. These assurances in turn become part of the contract between the airport and its airline tenants.

Majority-in-interest clauses

Majority-in-interest clauses in an airport's general use agreement usually give the carriers performing a majority of the operations at the airport a veto power over airport expansion, thus possibly preventing the construction of new gate space that could be used by entrants. These clauses are in effect at 55 airports, including 15 of the 27 largest airports and 11 of the 15 concentrated airports we reported on in our June 1989 testimony before this committee.[4] In 14 cases, these agreements give a single dominant airline a veto over airport expansion (see app. I).

Airport officials told us airports sign these majority-in-interest and other restrictive agreements because of their needs for capital funds. The more restrictive an agreement the airport signs, the greater the commitment the airlines will make to continue revenue-generating operations at the airport. The stronger the commitment from the airlines to generate revenue, the lower the cost of the capital which the airports must borrow. These restrictive agreements thus have the beneficial effect of reducing the cost of capital for the airports. The revenue commitment from the airlines can be a two-edged sword, however, because the majority-in-interest agreement may limit the airport's ability to expand and increase its capacity to raise revenue. The airport's revenue potential is also limited by the Airport Development Acceleration Act of 1973, which prevents the airport from charging passengers directly for the use of the facility.

As these long-term leases expire, some airports, such as Miami and Boston, are seeking to regain control over their facilities by requiring airlines to sign leases that are short-term or that have provisions that allow the airport to recapture the use of the gate if it is needed for another airline. More leases are being signed on a "preferential-use" basis that allows the airport to lease part of the use of a gate to an entrant airline at times when the primary leasing airline is not using it. However, the airlines are resisting these changes. In at least four cases, airports in our survey told us that the old exclusive-use leases expired years ago, but that the airlines have refused to sign new leases that would give the airport greater control over its facilities.

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[4] "Air Fares and Service at Concentrated Airports," (GAO/T-RCED-89-37, June 7, 1989).

Expansion plans

Many airports do not plan to expand. Fifty-four airports said they had no plans to build any additional gates in the next 5 years, and another 63 said they planned to add no more than 5 gates. Among large and medium-sized airports, 50 percent of the large and 39 percent of the medium plan to add 5 or fewer gates. Among the 15 concentrated airports we recently studied, 9 plan to add five or fewer gates. The airports in our survey cited funding as a major constraint on their ability to expand, and 8 of the 55 airports with majority-in-interest clauses cited them as a factor greatly limiting or delaying expansion. Many airports also cited opposition to noise and congestion as constraints on expansion.

Noise restrictions

Noise restrictions play an important role in reducing the adverse environmental impact of airports on their neighbors. However, by requiring the use of newer, more expensive aircraft, these restrictions can make it more difficult for new entrants to the industry that have older, less expensive aircraft to serve particular airports. Several of the new entrant carriers relied on older aircraft when they first entered the industry.

The most serious restrictions on noise occur at two airports in southern California that, according to airport officials, operate under court orders effectively prohibiting new entry altogether to control noise. Seven other airports use the alternative approach of establishing a noise budget or cap. These plans may restrict competition by requiring new entrant airlines to buy "noise rights" from incumbent airlines, who may be unwilling to sell. Another 20 airports raise the costs of entrants by banning the use of the noisier "Stage II" aircraft and limiting the use of the quieter "Stage III" aircraft.[5] Another 4 airports impose a lower cost by limiting the use only of Stage II aircraft. Large and concentrated airports are more likely to have these kinds of noise restrictions than small, medium, and unconcentrated airports. Overall, most of the airports in our sample did not have any restrictions on the kinds of aircraft that could be used.

SALES OF SLOTS HAVE DECLINED

Our analysis of FAA data on transactions that have taken place under the FAA's slot "buy-sell" rule leads us to conclude that the market for slots is not working as intended at the four high-density airports. Sales of slots have declined, and potential entrants have not been able to buy slots, even when the slots were not being used by the owner. Carriers have accumulated slots in excess of their present needs and have leased out those they are not currently using rather than selling them. Concentration in ownership of slots rose substantially at Chicago O'Hare airport.

In 1969, the FAA's "high density rule" went into effect at four congested airports--Washington National, LaGuardia, JFK, and Chicago O'Hare--restricting the number of landings and take-offs that could occur each day.[6] In order to land or take off at one of these airports, an airline had to secure a landing or take-off reservation, or "slot."[7] Slots were initially allocated by the airlines with CAB authority to serve the airport at the time the rule took effect, though FAA did on one occasion re-allocate a small portion of the slots to other carriers. The rule has helped to mitigate congestion at these airports and permit their safe use. However, since possession of a slot is necessary to establish service at one of these airports, the limitation in the number of slots impedes entry.

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[5] These stages are defined in Federal Aviation Regulation (FAR) Part 36, Sections 36.1 (f)(3) and (f)(5). The first generation of jets, such as the Boeing 707 and the DC-8-61, were classified as Stage I, and can no longer be flown in the United States unless modified to meet Stage II standards. Stage II aircraft meet standards issued in 1969 and include later generation jets such as the Boeing 727 and the DC-10. Stage III aircraft meet more stringent standards issued in 1977 and include jets currently being built such as the Boeing 757 and the MD-80.

[6] Newark was originally covered by the rule, but the rule was subsequently suspended at that airport.

In April 1986 the FAA amended the high-density rule to allow airlines holding slots to sell those slots to others. The rule's intent was to develop a free market in slots, so that any carrier wishing to acquire slots at one of these airports could simply buy them from another carrier. The FAA did not apparently envision that the leasing of slots would become widespread, but leasing was specifically permitted. The allocation of slots to carriers can be revoked or modified by FAA when required in the public interest.

A large volume of slots were sold in 1986, partly due to the forced sale to Pan Am of 76 slots used by New York Air in its shuttle operation,[8] and partly due to sales of 54 slots distributed by FAA in the slot lottery held that year. Of approximately 3,800 slots at all 4 airports, an average of 128 air carrier slots were sold per quarter in 1986, and 124 slots were leased.[9] This volume allowed the airlines with slots to re-allocate them to improve the efficiency of their hub-and-spoke networks and to absorb the effects of mergers. Since 1986, however, the number of slot sales has steadily fallen, from an average of 128 per quarter in 1986 to 20 per quarter in 1988.

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[7] Three major classes of slots were created, one for "air carriers" operating jet aircraft, one for commuter carriers, and one for non-scheduled flights. We have focused on transactions involving air carrier slots.

[8] The sale was a condition imposed by DOT in permitting Texas Air's acquisition of Eastern.

[9] We calculated the number of "slot-days" leased by multiplying the number of slots leased by the number of days for which each slot was leased. We then divided this figure by the number of days in a year to calculate the number of year-round slots to which these short-term leased slots would be equivalent. These year-round slot equivalents are shown above as the number of "leased slots."

While the intent of the buy-sell rule was in part to open access to slots to new entrants, not a single independent carrier has been able to establish new service at a slot-controlled airport by using slots bought on the free market.[10] This is partly because an increasing portion of the sales that do occur are between related carriers--either subsidiaries of the same holding company or code-sharing partners. Sales between related carriers rose from 14 percent of all sales in 1986 to 39 percent in 1988. As a result, sales between unrelated carriers have fallen from 110 per quarter in 1986 to 28 per quarter in 1987 and to 12 per quarter in 1988. Sales between related carriers are not open-market sales, and the increasing proportion of sales to related carriers further reduces the number of slots that have been sold on the open market and that are potentially available to new entrants.

Leases of slots, on the other hand, have risen from 109 slots in 1987 to 151 in 1988. Leasing of slots can allow the owner of the slot to ensure that the slot's user is not a direct competitor, because the slot owner does not give up control of the slot. For example, 15 percent of the leased "air carrier" slots, intended for the use of jet aircraft, are leased to regional carriers for use by small turboprop commuter planes. This practice prevents the slots from being used by competing jet carriers. Furthermore, 69 percent of all leases have been for 90 days or less. Such short-term leases give the lessees of these slots little assurance that any long-term investment in service (e.g., by leasing gates or advertising) will be worthwhile. However, short-term leases maximize flexibility for the airline controlling a slot.

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[10] Pan Am established its shuttle service between Boston, New York, and Washington by buying slots from New York Air, but this sale was mandated by DOT as a condition of its approval of the purchase of Eastern Air Lines by Texas Air, New York Air's owner.

Concentration in ownership of slots has not changed significantly since 1986 at Washington National, LaGuardia, and JFK airports. At Chicago O'Hare, however, slots have come increasingly under the control of American and United, and concentration in ownership has correspondingly risen. Between June 1986 and December 1988, the joint share of slots for American and United has risen from 65.1 to 74.5 percent, and the Herfindahl-Hirschman Index of concentration of slot ownership has risen from 2441 to 3008, an increase of 567 points.[11]

One airline that has sought to buy slots, particularly at Washington National and LaGuardia airports, reports that most slot owners are not even willing to seriously consider selling slots, and that those who are will not consider selling for less than $1 million per slot. This airline believes it could not enter the market profitably at these prices.

AIRLINE MARKETING STRATEGIES MAY REDUCE COMPETITION BY IMPEDING ENTRY

Airline marketing strategies are the second general category of factors that may inhibit competition by preventing or raising the cost of entry. These strategies include computerized reservation systems, frequent flyer plans, volume incentives for travel agents, and code-sharing agreements.

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[11] The Herfindahl-Hirschman Index of concentration (or HHI) is commonly used in antitrust and competition analysis. It is calculated by squaring the market shares of all the firms in the market, adding the squares, and multiplying by 10,000. The HHI ranges from 0 to 10,000. The Justice Department has characterized markets with HHI above 1800 as "highly concentrated," and regards a merger in a highly concentrated market which increases the HHI by more than 100 points as a matter of significant competitive concern that may be subject to challenge on antitrust grounds.

Computerized Reservation Systems

As we testified last year before the House Aviation Subcommittee, airline-owned Computerized Reservation Systems (or CRSs) earn profits exceeding those that could reasonably be expected to be earned in a competitive market.[12] These high profits are earned through high booking fees and incremental revenues, which transfer profits from airlines that do not own CRSs to those that do. This transfer artificially raises the costs of carriers not owning CRSs, making it more difficult for them to compete in markets against a CRS vendor. Restrictive provisions in contracts between CRS vendors and travel agents regarding, for example, minimum use, make it virtually impossible for new airlines to start their own CRSs.

Frequent flyer plans

Frequent flyer plans are a popular bonus for which millions of passengers have signed up in the hope of gaining free airline tickets. They provide rewards to travelers for flying extensively on a single airline. To the extent that passengers use these plans heavily, and to the extent that passengers prefer to use the plans of dominant airlines, the plans could discourage passengers from trying out a new competitive entrant in a market. Our analysis of frequent flyer plans indicates that these plans are widely used, that they have features designed to encourage travelers to concentrate their travel on a single airline, and that travelers seeking to concentrate their travel are likely to concentrate on the airline with the most service from the traveler's point of origin. Frequent flyer plans therefore have the potential to benefit the dominant airline in its markets and to discourage travel on airlines new to those markets.

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[12] "Competition in the Airline Computerized Reservation System Industry" (GAO/T-RCED-88-62, Sept. 14, 1988).

Frequent flyer plans have a substantial impact on booking patterns. Three-fourths of the travel agents we surveyed told us that their business customers choose their flights on the basis of their frequent flyer plans more than half the time. Further evidence that frequent flyer plans are heavily used comes from a 1986 study based on a survey of 204 corporate travel managers. This study found that the travel managers believed that frequent flyer plans resulted in higher fares and unnecessary travel, and that this wasted more than 5 percent of their corporate travel expenses.[13]

A frequent flyer who concentrates travel on a single airline will earn awards more quickly. Our analysis of frequent flyer plan provisions shows that some plans also have features that encourage passengers to concentrate their travel on a single carrier. Some, for example, are designed so that the value of the award earned with later 10,000-mile blocks flown is greater than the value earned with the first 10,000-mile block. Thus, a passenger who has already flown 30,000 miles with one airline would be better off flying another 10,000 miles with the same airline rather than flying an initial 10,000-mile block with a second airline. Others have deadlines on the use of mileage so that a traveler can only reach the higher award levels if miles are accumulated quickly within a limited period of time. Travelers who spread their travel across several airlines may find that the mileage has expired before accumulating enough on any one airline to earn an award.

A passenger wishing to concentrate travel on a single carrier is likely to use the carrier that offers the most service from the traveler's origin point. While a carrier new to a market can also offer a frequent flyer plan, the dominant carrier in a market will give the traveler the most opportunities to accumulate miles quickly. The travel agents we surveyed cited ease of building up miles as the leading factor in choosing a frequent flyer plan. Passengers who participate actively in a frequent flyer program will thus have an incentive to book as much of their travel as possible on the dominant carrier in a market. Heavy use of frequent flyer plans can thus make it more difficult for a carrier to enter a new market where an established carrier already offers a substantial amount of service.

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[13] Frederick J. Stephenson and Richard J. Fox, "Corporate Attitudes Toward Frequent Flyer Programs," Transportation Journal, v. 27, no. 1 (Fall, 1987), pp. 10-23.

Volume incentives

Airlines provide various kinds of volume incentives to travel agents, including TACOs, overbooking privileges,[14] free tickets, and VIP Club memberships.[15] These incentives are provided as a reward for the agent surpassing a given threshold level of ticket sales on the airline paying the incentive. They provide a source of extra income to travel agents and, in some cases (e.g., overbooking privileges and VIP Club memberships), allow the agent to provide enhanced service to favored clients. If airline passengers leave the choice of an airline to the agent, these volume incentives could induce agents to book more passengers on the airline providing the volume incentives.

Most of the travel agents we surveyed received volume incentives of various kinds from the airlines. The most popular form of volume incentive was the commission override. Most of the agents receiving overrides said they were an important part of the agency's overall revenues. The travel agents also told us that passengers often leave the choice of the airline to the travel agent. While the most important considerations for the agent in making these choices were fares and passenger convenience, several agents told us that they based their choice of a preferred airline on which airline provided commission overrides or overbooking privileges. Last year, DOT issued its report on CRSs, which analyzed the effects both of CRS ownership and of commission overrides on booking patterns of agents.[16] DOT concluded that commission overrides significantly increase the number of tickets that an agent will book on a particular airline.

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[14] Overbooking privileges are the right to book an extra passenger on a flight that is already fully booked. Airlines usually overbook their flights in any case to compensate for passengers who make reservations but don't show up for the flight. Providing overbooking privileges to agents extends to the agent the privilege normally reserved to the airline. Agents told us they value these privileges because they allow the agent to do a favor for highly valued clients.

[15] VIP Clubs are special waiting rooms that airlines provide for their favored passengers. These special waiting rooms provide a higher level of service than regular airline hold rooms.

The evidence available to us suggests that commission overrides and other volume incentives influence the number of tickets that are sold on the various airlines competing in a market. When the dominant carrier in a market pays override commissions, the need to match these volume incentives may increase the cost of entry for an entrant carrier. An entrant that is well-financed may be able to enter successfully, while an entrant with fewer resources may be deterred.

Code-sharing

Passengers often must make connections between two flights when no direct flight between two points is available. A connection between two flights of the same airline is called an "on-line" connection; a connection between two flights of different airlines is called an "interline" connection. Since deregulation, a third type of connection has become popular, the "code-sharing" connection. Under code-sharing, two airlines that are separately owned agree to share the two-letter code of the larger airline in identifying their flights.

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[16] U.S. Department of Transportation, "Study of Airline Computer Reservation Systems" (DOT-P-37-88-2, May 1988).

The purpose of a code-sharing agreement is to market the services of the two airlines jointly. Typically the smaller airline does business under the name of the larger airline, repaints its planes in the larger airline's colors, and coordinates schedules with and relocates its gates near those of the larger airline. The small commuter carrier encourages its passengers to connect with its major partner, and vice versa. Some industry officials say that code-sharing can be a barrier to entry because it discourages the smaller regional carrier from providing interline traffic to any carrier other than its code-sharing partner. This problem is worsened, the airlines said, by the fact that CRSs give preference to code-shared connections over interline connections in ranking flights on the CRS screen.

The travel agents we surveyed reported that their customers expressed some preference for code-shared flights relative to interline flights. Passengers particularly cited the greater convenience of gate locations of code-sharing airlines at airports where the passenger must change planes. While code-sharing may have some anticompetitive effects, it appears also to have some consumer benefits.

POLICY OPTIONS

The data we have gathered on potential barriers to entry in the airline industry indicate that some features of airline markets are likely to discourage entry. Slot controls, gate leases, and, at a few airports, noise restrictions are likely to restrict access to the essential facilities needed to establish competing service. While we do not have definite estimates yet from our econometric model of the impacts of these restrictions, we believe they are likely to restrict entry and inhibit competition.

The effects of some of the airline marketing strategies are less clear. CRSs, as we indicated in our testimony last year, appear to have a clear anticompetitive effect, and we have urged DOT to consider possible remedies. Frequent flyer plans appear to present a clear potential for disadvantaging entrants. However, because of the lack of data on levels of use of these plans, it may not be possible even with the results of our econometric model to estimate these plans' effects. TACOs appear to offer a less compelling basis for disadvantaging entrants. We do have some data on TACOs, however, that may be able to show their effect on fares. Code-sharing may have some anticompetitive effects, but also appears to offer some consumer advantages that may offset these effects.

We recognize that the Committee is considering taking action to minimize the possible anticompetitive effects of the practices we have discussed. During the course of our work, we have identified various policy options. Though not an exhaustive list, our preliminary evaluation suggests that they can provide a framework for analysis and deliberation. All of these options involve important policy considerations and require a careful weighing of costs and benefits and an assessment of trade-offs.

Gate access

Airport facilities are essentially local responsibilities, yet most operate under federal restrictions imposed by the Airport and Airway Improvement Act of 1982. This act requires that airports receiving federal grants be public use facilities, available for all to use on an equal basis. One policy option would be to extend additional federal restrictions on new leases so as to reduce the long-term control that leasing airlines acquire over the airport's facilities. Airlines need some assurance of access to an airport's gates to justify their investment in providing service. However, it might be possible to provide this assurance without giving the airline the broad control over a gate that an exclusive-use lease provides. A preferential-use gate, for example, gives the leasing airline access to the gate whenever it needs it, while still making the gate available to others when it is unused. Several airports have acted to regain control over their facilities, either by requiring short-term or preferential leases or, as Omaha and Grand Rapids have done, by not renewing majority-in-interest clauses.

Another policy option would be to reduce the federal restrictions that make the airports dependent on the airlines as a source of revenue. The Airport Development Acceleration Act of 1973, for example, prohibits the airports from imposing any direct passenger facility charges on the passengers using the airport. The airports argue that this act, by preventing the airports from charging the passengers directly, forces them to rely on the airlines as a source of revenue, thus giving the airlines more bargaining power in lease negotiations. Airlines believe that it is appropriate for them to control airport expansion, and also have been concerned that municipal authorities would use revenues from passenger facility charges for non-airline purposes. However, the 1982 Airport and Airway Improvement Act requires airport operators to provide the Secretary of Transportation with assurances that all local revenues will be expended for airport purposes as a precondition for obtaining federal airport grants. Passenger facility charges could help solve the funding problems that have prevented airport expansion and reduce the airports' need to seek majority-in-interest clauses.

Noise restrictions

A small number of airports have particularly stringent noise restrictions that, while not imposed by airlines, can be a substantial entry barrier. While all parties agree on the desirability of reducing airport noise, they disagree on the questions of the pace and strategy for doing so. These contentious issues have often set local and national interests at odds, and it is not clear how far federal efforts to impose national noise policies should go. Some airports (such as Boston and Denver) have adopted noise rules that have waivers to ease entry while still achieving the desired level of noise reduction. Further exploration of noise control strategies might identify other approaches that would allow airports to control noise while minimizing adverse impacts on competition.

Slot restrictions

In our view, the buy/sell rule for airport slots has been ineffective at encouraging entry into slot-controlled markets. Our analysis of FAA's data indicates that no new entrants have been able to establish service by buying slots; that the number of slots sold has steadily declined; and that the slot market is increasingly becoming a short-term leasing market, in which major carriers that have accumulated excess slots lease out rather than sell the ones they do not need. The leasing market, while permitted in FAA's original formulation of the market, appears to have been considered the exception. It is now the exception that is becoming the rule. Several outside studies have found that the presence of slot controls increases airline fares significantly.[17]

By allowing a public right--the right to use the nation's airspace--to be treated in some respects as a private asset that is not generally available on the open market, the present operation of the buy/sell rule not only restricts competition at

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[17] See, for example, David R. Graham, Daniel P. Kaplan, and David S. Sibley, "Efficiency and Competition in the Airline Industry," Bell Journal of Economics, vol. 14, No. 1 (Spring 1983), pp. 135-136; Elizabeth E. Bailey, David R. Graham, and Daniel P. Kaplan, Deregulating the Airlines (Cambridge: MIT Press, 1985); Gregory D. Call and Theodore E. Keeler, "Airline Deregulation, Fares and Market Behavior: Some Empirical Evidence," in Andrew F. Daughety (ed.), Analytical Studies in Transport Economics (Cambridge: Cambridge University Press, 1985), pp. 221-247; and Stephen A. Morrison and Clifford Winston, "Empirical Implications and Tests of the Contestability Hypothesis," Journal of Law and Economics, vol. 30 (April 1987), pp. 61-62.

the four slot-controlled airports, but can impede competition throughout the northeastern and midwestern United States. These airports are a critical part of any air traffic network in the northeastern or midwestern parts of the United States. It is difficult for any carrier to become an effective competitor in these heavily populated parts of the country without access to these four airports. The short-run access to slots that leasing permits is a risky basis on which to invest in a long-term service commitment (e.g., by leasing gates and investing in advertising).

We believe that something should be done to open up the slot market so that permanent entry becomes easier at slot-controlled airports. We are particularly concerned about proposals to extend slot restrictions as currently structured to other congested airports. One solution to this problem would be for the FAA to lease slots to the airlines rather than allow them to retain the control of slots that were given to them for nothing. Leasing would have the advantage both of generating revenue for the federal government and of opening up the slot market to new entrants. It would be essential, in establishing such a market, to recognize that airlines need to have assured access to slots for a long enough period to make reasonable investments in serving routes from that airport. It would be equally important, however, to ensure that the leases ran for a limited period of time so as to prevent the slots from becoming the de facto property of the leasing airlines (as gates have become at airports that have long-term gate leases). Lease terms could be staggered so that leases would be long enough to assure continuity of service while ensuring that some leases would come up for renewal each year, giving entrants an opportunity each year to bid on airport capacity.

An alternative would be for DOT, under the provisions of the current buy/sell rule, periodically to withdraw a portion of the slots and reallocate them by lottery. Incumbent carriers would have the opportunity to buy the slots back from the winners of the lottery, but at least new entrants would have an opportunity to

secure slots, either through the lottery itself, or by bidding on slots sold by lottery winners.

Computerized reservation systems

In our testimony last year on CRSs, we discussed a number of policy options, ranging from divestiture of airline-owned CRSs to non-airline owners to modifications in vendor contracts with travel agents. We continue to believe that further action is warranted to remedy the anticompetitive features of the CRS industry. As we emphasized in our earlier testimony, action in one area, such as reducing or eliminating booking fees, could create problems in another area, such as increases in CRS subscription fees to travel agents. Consequently, travel agents' bargaining power with CRS vendors would have to be increased by modifying restrictive contract provisions, e.g., length of contract terms and minimum use clauses. While DOT is making further investigations into the competitive impact of CRSs, it has not acted to open any regulatory proceedings, as we recommended it do last fall. It is especially important that DOT begin to act since its CRS rules will sunset at the end of 1990.

Other airline marketing practices

The three other airline marketing practices that we have discussed--frequent flyer plans, TACOs, and code-sharing--have effects that are more difficult to measure. Frequent flyer plans have proven to be extremely popular promotional tools, but they have the potential to reduce competition in markets where a single carrier has a dominant market share. Frequent flyer plans offer a literal free ride to their participants, but these free trips are paid for in the form of higher fares for the average traveler and possibly also in the form of excessive business travel. DOT, in its Information Directive of June 14, 1989, has requested information on frequent flyer plans which may help to resolve the question of their impact on competition. Travel agent commission overrides, overbooking privileges, and other volume incentives clearly have some effect on the pattern of airline bookings. They increase the cost of marketing tickets and thus may pose an entry barrier to entrants with less access to capital than established airlines have. Code-sharing agreements offer some advantages to airline passengers, while also probably having some anticompetitive effects.

All these practices are subject to regulation by DOT under its authority to regulate anticompetitive practices in the airline industry. Should anticompetitive effects of these practices be demonstrated, they could be either prohibited or modified in some way so as to reduce any anticompetitive impact. The popularity of frequent flyer plans may make action to reduce their anticompetitive effect unpalatable. For example, one modification short of outright prohibition would be to require that mileage be transferable from one plan to another or from one passenger to another. While this would reduce the potential anticompetitive effects because passengers could earn valuable miles on any airline, such a requirement could make the plans so unattractive to the airlines that they would withdraw them.

If TACOs were prohibited, airlines might well resort to other kinds of volume incentives. If code-sharing agreements were prohibited, airlines would probably just buy out their code-sharing partners or develop commuter subsidiaries internally, as several airlines have already done. An important part of the success of code-sharing has been the preference that code-shared flights are allowed in CRSs, where code-shared flights are generally listed ahead of interline flights. It would be possible to prohibit CRSs from listing code-shared and on-line connections ahead of interline connections, as the European CRS rules propose, but this would make it more difficult for travel agents to find code-shared flights for passengers who prefer code-shared connections.

CONCLUSIONS

While our analysis is not yet complete, the work we have done so far indicates that some features of airline markets are likely to discourage entry. The factors that appear most likely to discourage entry are gate access problems, slot controls, and CRSs. We have offered some alternatives for reducing the potential anticompetitive effects of these factors. While not an exhaustive list, these options involve important policy considerations and require a careful weighing of costs and benefits and an assessment of trade-offs. While the effects of some of these factors seem fairly clear, the effects of others are still uncertain. As we obtain further results from our econometric model, we will be able to provide the Committee with more information on the relative significance of these factors. And as the significance of these factors becomes clearer, we would be happy to work with the Committee on further analysis of possible solutions.

That concludes my testimony. I would be happy to answer any questions you may have.

AIRPORTS AT WHICH ONE AIRLINE CAN BLOCK APPROVAL OF EXPANSION PROJECTS UNDER A MAJORITY-IN-INTEREST CLAUSE

Airport	Airline	Airport size	Concentrated[a]	MII[b] expires
Atlanta, GA	Delta	Large	C	2010
Asheville, NC	USAir	Small	O	1990
Burlington, VT	USAir	Small	O	1996
Baltimore, MD	USAir	Large	O	1993
Charlotte, NC	USAir	Large	C	2016
Chattanooga, TN	Delta	Small	O	1992
Charleston, WV	USAir	Small	O	1988
Cincinnati, OH	Delta	Medium	C	2015
Dayton, OH	USAir	Medium	C	1996
Dallas/Fort Worth, TX	American	Large	O	2009
Lexington, KY	Delta	Small	O	2001
Chicago/Midway, IL	Midway	Medium	O	1995
Minneapolis/St. Paul, MN	Northwest	Large	C	1989
St. Louis, MO	TWA	Large	C	2005

[a] Airports marked "C" are the concentrated airports we reported on in our June 1989 testimony; airports marked "O" are other airports, including all the unconcentrated airports as well as the concentrated airports (such as Dallas/Fort Worth and Midway) in multi-airport cities.

[b] "MII" refers to "majority-in-interest" clause.

Senator **Ford**. Thank you very much, Mr. Mead, for your usual very thorough and comprehensive statement.

One thing, when you make these suggestions, one of the questions that popped into my head was how can we impose all these suggestions that you relate.

Looking at cost buying, new airlines and replacement airplanes, there are back orders for airplanes now. How do you think we would be able to financially increase the competition that is there by imposing these suggestions?

Mr. **Mead**. Well, it seems to us if you focus on some of the physical barriers to entry such as gate leases, trying to encourage making them preferential as distinguished from exclusive, focusing on slot controls, you might not face some of the problems that would occur.

In the noise restriction area, for example, the problem there is that stage III aircraft are the quietest aircraft, and they are the ones that are being made now. The production line for aircraft is pretty tight right now, and it is difficult to purchase new planes.

Senator **Ford**. There is a five- to six-year wait.

Mr. **Mead**. Yes.

Senator **Ford**. Are we seeing communities by ordinance getting the quieter planes and those who have not passed an ordinance and have a desire for air transportation getting the more noisy aircraft?

Mr. **Wells**. I think that is true, sir, yes. Some of the airports, particularly in California, have imposed restrictions that require all of the aircraft serving that airport to be stage III aircraft. Certainly, the overall fleet composition of the U.S. aircraft fleet is nowhere near close to 100 percent stage IIIs, so that the noisier stage II aircraft are forced to be used at other airports that do not have noise restrictions.

So there is in a sense a shifting of stage II aircraft to the airports that do not have noise restrictions.

Mr. **Mead**. Our information, Mr. Chairman, is that about 70 percent of the fleet right now is so-called stage II aircraft, which of course is quieter than the stage I, and the rest are stage III.

Senator **Ford**. So roughly a quarter of the air fleet today is stage III, and California says you cannot fly in here or land anywhere unless you have stage III. That does cripple the rest of the country, does it not?

Mr. **Wells**. That is at three individual airports, not at all California airports.

Senator **Ford**. That is the three major airports where you have overwhelming predominance of air traffic.

Mr. **Wells**. It is particularly Long Beach, Orange County and Burbank.

Senator **Ford**. Mr. Mead, in your view have the Departments of Transportation and Justice done an adequate job ensuring competition among the various airlines?

Mr. **Mead**. I would like to join with Senator McCain's observation in his opening statement. The answer is no, not until very recently. Certainly the Justice Department is a different case because the Justice Department really was not involved in the mergers other than commenting on them. In fact, it commented that some of the mergers should not go through.

The Department of Transportation, though, under the prior administration simply was, in our view, not very attentive to these competition issues, and now Secretary Skinner is trying to catch up. From all of our observations and interactions with the people, we are quite encouraged.

It is unfortunate that this attention is being paid now after all this concentration has occurred. It is a much more difficult equation to deal with now that we have such heavily concentrated markets.

Senator FORD. That is the nature of this bird, is it not; react instead of act?

Mr. MEAD. I would like to add on the computer reservations services that for several years not just GAO but many people in the community—travel agents, GAO, and others—have been saying that it is time to do something about the CRSs. It was just recently that the Department of Transportation announced that it is proceeding to invite comments on what types of rules would be appropriate.

Senator FORD. Was there an effort made by a couple of major airlines to set aside or to move the CRS out of their operation into independent field with the authority of others to purchase a portion of that and try to work out a separate entity to get it out of the airlines' dominance?

Mr. WELLS. I think it is true that the CRS vendors have to some extent acted on their own in response to the concerns that this committee and the House Aviation Subcommittee have shown about market power in the CRS industry, but we have certainly been concerned that DOT has not pushed the CRS vendors very hard in that direction.

Senator FORD. Of course, the latest attempt was turned down by the Justice Department, as I understand it. In the past, whichever way Justice rules DOT has gone the other way. So I do not know that we even need Justice to make a decision when you know basically what DOT is going to do.

Mr. WELLS. The proposed Sabre-Datas merger had, I think, a number of mixed considerations. On the one hand, it opened up the possibility for non-CRS vendor airlines to buy into a CRS system. On the other hand, it combined two of the existing CRSs and therefore reduced the existing level of competition in the CRS market.

So I think that while the former consideration was positive, the latter consideration was more negative. It was that consideration that led DOT and the Justice Department to oppose that combination.

Senator FORD. It does not make sense to me when you are pressuring businesses to do certain things and they make an effort without giving up all their financial interests. They were out there in front and made a judgment and made the expenditure, and then they come together to try to take it out of their corporate structure. It would also be owned by other airlines that wanted to buy 10 percent of it.

So we find DOT saying no, you cannot do what we have been asking you to do. We are going to have to do our own thing. It seems, at least in my view, if the businesses are going to accommodate that which we are having problems with, let them accommodate without the government telling them what they ought to do.

Mr. **Wells**. I would not contradict you on that, sir.

Senator **Ford**. Thank you very much. I will ask the next question.

Mr. Mead, you referred in your statement to GAO earlier this year that fares at concentrate hub airports were on average 27 percent higher than at other airports. You said your current study will not be ready until later in the fall.

Does any of your preliminary data in your current study relate to your earlier work, or is it basically the same? Has the 27 percent come down, or does it appear to be going up?

Mr. **Mead**. If I might first explain what the strategic plan of our work for the committee is, I would then have a response to your question.

First, you may recall about a year ago this all started off with GAO looking at what was going on in the St. Louis market, because of concerns about the merger there. After the St. Louis report came out there was a concern that the situation in St. Louis could be replicated in other markets that were concentrated at somewhat lesser or even greater levels.

So we completed in June a piece of work that focused on whether concentration made a difference. That was the purpose of the work we testified on in June.

What we are finishing right now and what we are reporting on to you today is an effort that was designed to look at how prevalent these barriers to entry were and whether, as alleged, they in fact were barriers to entry.

The next phase, the econometric model that I mentioned earlier, is an attempt to measure the influence of these barriers to entry on fares. We may not be entirely successful. It is a very complicated undertaking, trying to quantify it so you can give people the answers as definitively as they would like.

Senator **Ford**. We use the term around here "best information available".

Mr. **Mead**. I am glad to hear that, Mr. Chairman.

Senator **Ford**. If this committee were to select one of the barriers to entry which you identified as needing immediate attention, which one would you suggest we pursue to enhance competition?

Mr. **Mead**. My choice is limited to one, slots. The reason I say that is because slots do not just affect four airports, the four slot-controlled airports. They affect many airports all over the country because the slot for O'Hare, for example, is not linked to necessarily having a slot at LaGuardia. A plane that wants to go from Los Angeles to Chicago needs a slot in Chicago.

So I would say that the slot situation is pervasive, and that clearly needs some attention.

It is also interesting to note that the slots are in a way a public property being sold or leased as though they were private property.

Senator **Ford**. Well, airways and so forth, whatever you get into, that is basically a question that you can always pose.

You have suggested, Mr. Mead, the possible imposition of passenger facility charges at our airports with capacity expansion needs.

Given the fact that the Airport and Airway Trust Fund currently has a surplus approaching $7 billion, all of which is intended for capital development of the air transportation system, do you believe it is appropriate that Congress authorize additional aviation taxes?

Mr. MEAD. Well, first of all, the passenger——

Senator FORD. Your silence almost gave me an answer, Mr. Mead.

Mr. MEAD. I have to think through my answer carefully.

First of all, the passenger facility charge observation that we made is one of several alternatives for dealing with the problem. I do not want to cast it as a GAO recommendation.

I am not a student of politics as to what is going to happen and how likely it is that the surplus in the trust fund is going to be made available anytime soon in the amount of $8 or $9 billion or whatever it is today.

Senator FORD. If I can pass S. 1600, an independent FAA with its content, it will be available.

Mr. MEAD. That would help, but also the passenger facility charge approach is designed to lessen the airport authority's reliance on the airlines as a financing mechanism.

Mr. NOEL. Let me add something here, because I think we need to separate what we are buying with what.

The trust fund is mainly aimed at financing the NAS Plan and the development of the airways to get from one airport to another. The trust fund provides a small portion through grants of the funds.

Senator FORD. Let me just disagree with you a little bit. The trust fund was authorized for capital construction.

Now if you take the NAS Plan, including the communications system to get safely from one airport to another, your view of the trust fund and this Senator's view of the trust fund is somewhat different. We have general fund contributions, as you know, for paying FAA operating expenses. But the 8 percent tax that we now have on a ticket when you fly goes into that trust fund. But unfortunately we do not spend it.

We have the trigger tax reduction now in place. You know, if you do not spend it the tax is reduced. I see nothing wrong with that. If you are not spending the money that it is taxed for, why not just drop it.

I want you to know that this Senator does not agree with you, and I want to get it in the record at the point in which you made that statement, Mr. Noel.

Mr. NOEL. Fair enough, Senator Ford.

Mr. MEAD. I might point out that other work that we have done on the trust fund would suggest that the balance that you have, the so-called surplus, is going to be needed for existing projects in the modernization program as well as for operations and maintenance.

I know the new NAS Plan is not yet available, but Admiral Busey just the other day was mentioning how the cost of the National Airspace System Plan, the modernization initiative, is much more than had been contemplated earlier. He is overhauling that, and I do not know what his figures will come up as. Certainly, that is an object that we want to be covered out of the trust fund.

Mr. NOEL. If I could just continue my point briefly, the airports in building their facilities, they get some monies from the trust fund, and we might debate how much they should or do get from that. And they get some monies from revenue bonds that they float for which they have primarily depended upon the majority-in-interest clauses to get them a low rate of financing.

Now, the suggestion here is simply that by using the passenger facility charge to provide some of that revenue—not all, perhaps, and maybe some more should come from the trust fund—that would free them up from having to sign these majority-in-interest clauses with the airlines and, therefore, that control that the airlines have over what they do would be diminished.

It is not to say that it all should not come from the trust fund or exactly who should pay for it, but to provide a mechanism that reduces the control the majority-in-interest clauses provide for the airlines.

Senator FORD. Mr. Noel, I know I need to turn this over, but if you are going to impose a charge on an airline, how do they substantiate that? How does the CEO say to his stockholders it was a good deal. We are making money on it. He gets something for signing the contract, for paying more, and I find that you charge the passenger, you charge the airline, you charge general aviation, you have a fee on hotels and motels downtown and part of it goes into the airports.

You just begin to put all kinds of tax on, and we are sitting here with $7 billion we put on and we are not getting it out. And so, that would relieve some of our local facilities.

Your airport executives are having a hard time putting everything together therein. We had to fight them on rental cars here, you know, and so we have had everything here, you know. Everybody is fussing and fuming and carrying on, but we are the culprit, in my opinion, because we are not spending the money as we are getting it. That is the blue smoke and mirrors that we use on the budget.

We have 160-some-odd trust funds. Last year those trust funds took in 53 percent of the federal general fund. Every little piece that we get is going somewhere. Then we are not spending it. And so if you begin to look at all of our problems, we have got more than have surfaced.

I would turn it over to my friend, Senator McCain.

Senator MCCAIN. Thank you very much, Mr. Chairman. I share your view on the trust fund problem. I think it is an insult and an outrage to the airline passenger that we are keeping this money. We are basically deceiving them when we tell them that they are paying an additional tax which, at least for some years now, has not been spent for the purpose for which we have taken those monies.

And I think if more airline passengers knew that fact, I think there would be a greater degree of outrage concerning this situation and perhaps maybe we could move on it.

But, Mr. Mead, I want to thank you and Mr. Noel and Mr. Wells for what you have provided the subcommittee. I think the information you have given us, not only at this hearing, but previous hearings as well has been very important and very educational to this member.

Let me say as part of the team, I do have some difference on the latest Department of Transportation decision concerning the proposal about the CRS that was made and was turned in.

It was the view of the smaller airlines that this proposal was anti-competitive in nature. Is that not true, Mr. Mead?

Mr. MEAD. I think that they would not have been a part of it.

Mr. NOEL. I think, for example, the cost of buying into the Sabre-Datas merger was very high, and I think a lot of the small airlines were concerned that this was a cost of capital that they simply could not afford.

Senator MCCAIN. So, in reality, the reason why the Department of Transportation turned this down is because it was anti-competitive in its final impact. The merger would not increase access for the small airlines or result in a more competitive environment, is that not the case?

Mr. MEAD. Yes, sir, and also I think it is appropriate to note that the airlines, some of the majors have a CRS, American's and United's being the largest.

But, the so-called national airlines that are attempting to become majors are not a part of the action. Yet, on every ticket that is booked, they will have to pay the $2 fee to the airline owning the CRS. In addition, there is the halo effect, the so-called incremental revenue.

Senator MCCAIN. Indeed. In fact, I note with some interest that just yesterday some of the representatives of the airlines came to my office with a new proposal which would give much greater access to these smaller airlines. With all due respect to my friends in the airlines, I think that they feel that they need to move on this issue, otherwise we will.

And that brings me to my first question to you. Do you feel that a congressionally mandated divestiture would be the most effective method of dealing with most of the anti-competitive aspects of the CRS system?

Mr. MEAD. Last year when we released our work on the CRSs, we laid out a series of options. Certainly divestiture is one of those. We are not prepared to say that it is the best route, but the time has clearly come to lay out the different options on the table and decide what we are going to do.

One problem with the divestiture, if it is divestiture to a non-airline-owned outfit, is that the incremental revenues will not be there anymore to help fund the airline. So, the booking fees would have to be correspondingly higher, presumably to cover the cost.

There are other options, too. One we have heard of is an industry-wide consortium in which they are all members. That would require a divestiture of some sort, with the result that you would have a nonprofit consortium with booking fees set at cost—right now they are at least twice what the costs are; this would eliminate incremental revenues.

Senator MCCAIN. But then you would also have to have some provision for a new airline that comes in to become part of the system, too; otherwise you would lock in the existing number of airlines.

Mr. **Mead**. Absolutely. So, the answer is, we are not prepared to say that divestiture is the best way to go.

What we are prepared to say is look, we know what the range of options are. Certainly divestiture is one of them, with the industry-wide consortium regulating booking fees; putting restrictions on the clauses, the liquidated damages clauses in travel agent contracts is another option and this would encourage agents to seek out other CRSs. But, the time has come to figure out what we are going to do.

Senator **McCain**. And the CRS is clearly one of the most anti-competitive aspects of the airline industry today?

Mr. **Mead**. I do not think there is too much question about that.

Senator **McCain**. On the frequent flier program—and I must say in all candor we are very hesitant, obviously, to address that issue clearly, because it is incredibly popular with Americans—it is clear to me that it has its anti-competitive aspects.

One of the possible solutions you recommended was to make mileage and benefits transferrable from one airline to another. Was that not in your report?

Mr. **Mead**. It is in there more to show that perhaps regulation of these programs is not that realistic because I do not know how fair it is to the airlines to say, "we really like your frequent flier programs. In fact, we like them so much that whenever we fly on any airline, we want flier mileage awards, and any airline has to honor them."

Senator **McCain**. I guess my point is that if you did that, it would result in the disappearance of the program because there would be no advantage to the airline to have a program of that nature.

Mr. **Mead**. That is right.

Senator **McCain**. So, that really is not a viable option.

Mr. **Mead**. That is why we offered it—to just illustrate that point.

Senator **McCain**. Let us go back to slots for a second, if we could. Right now there are slots that are used only a few hours of the day, or even less. Is that not correct?

Mr. **Mead**. Yes.

Senator **McCain**. Would not one of those solutions be to require that the owners of those slots allow other airlines to use those slots if they are not in use?

Mr. **Mead**. There is a use-it-or-lose-it rule in effect and—correct me if I am wrong, Jack—I think it has to be used 65 percent of the time.

I do not know how closely that is monitored.

Senator **McCain**. Explain to me the rationale, if the major airlines got these slots free. Is that right?

Mr. **Mead**. Yes.

Senator **McCain**. If they got them for free, how do you rationalize them being able to sublease at a profit?

Mr. **Mead**. I have a very difficult time doing so.

Senator **McCain**. So, in your view, that is not a correct or appropriate use of slots?

Mr. **Mead**. That is correct. You see, these are public. It is really public airspace that is given out to the airlines, and it is a very valuable piece.

Senator **Ford**. And the airlines use these as assets?

Mr. **Mead**. Yes, sir.

Senator **Ford**. And it keeps some airlines from going under, so it is something they receive free has become very valuable, which belongs to everybody?

Mr. **Mead**. That is correct. In fact, Mr. Chairman, some of the more valuable assets of the Eastern Airlines were, in fact, the slots.

Senator **McCain**. And your solution for it?

Mr. **Mead**. I think you have two choices. One is for the government to lease the slots to the airlines for a fee.

Another approach that would not require a financial transaction would be for the government to periodically withdraw a series of these slots.

The current rule for the slots, incidentally, specifically says they are not your property, and we can withdraw them at any time. So, it is not a case of the airlines not being on notice of this and just to periodically reallocate the slots.

You could have the slots on staggered terms so that an airline that is vested on a particular route would not stand the likelihood of losing all of its slots on the reallocation by lottery.

Would either of you like to amplify on that?

Mr. **Wells**. No, I do not think so.

Senator **McCain**. And the indications that you have is that the sale of these slots—transfer of these slots from airline to airline—is gradually decreasing?

Mr. **Mead**. Very sharply. There have been sales that are occurring between related airlines, but I do not think it is reasonable to characterize those as sales on the open free market.

Senator **McCain**. In fact, those sales would contribute to concentration rather than decrease concentration.

Mr. **Mead**. Yes.

Senator **McCain**. Mr. Chairman, I apologize for taking so much time. I also apologize to Senator Danforth, but let me mention two other issues. Again, I would like to recognize the involvement of Senator Danforth. I think he was very heavily involved in this, and we appreciate very much his commitment on the issue.

I have two questions which are not in the scope of your study. Number one is LBOs. I would like you to comment on the recent phenomena of takeovers of major airlines and its effect on competition.

Mr. **Mead**. We are not doing a great deal of work on LBOs. We are following the issues.

James, do you want to comment?

Mr. **Noel**. I think the concern here is whether—if I could just frame what I see as a couple of the issues as someone who has been looking at this industry for a good little while. One, of course, is that in an LBO a large amount of debt is being accumulated to finance the purchase. The issue is what will happen, if the industry resumes its cyclical nature and we have a recession and there is a downturn in income. I think that is a concern, although certainly many carriers—with Eastern being a good example, as well as Pan

Am, and some others—have survived a very long time under pretty trying financial circumstances. So, the burden really shifts over to the FAA to make sure that they maintain adequate oversight so that safety is not compromised, because I think that is the primary goal.

Senator McCAIN. Does it also concern you that, since clearly the airline industry is going to be an international competition environment, a company that is in debt up to its eyeballs would have difficulty competing with an airline such as Lufthansa, that has enormous cash reserves? All of the European airlines have enormous cash reserves. Is that a matter of concern?

Mr. MEAD. The international issue is, of course, a very important emerging issue, something that we are all going to be sitting up here testifying on, I think, probably a year from now, maybe even before then.

I think there is some question about how well equipped the U.S. government is to consider those issues within the framework of their current authority.

As I understand it, there are rules currently in place limiting the amount of ownership by a foreign airline to 25 percent. There are ceilings on the board membership, but there is a concern here about other types of control.

Senator McCAIN. And influence and marketing decisions.

Mr. MEAD. Yes. And I do not know if it is reasonable to conclude that the existing authority is adequate to deal with that.

Mr. NOEL. I think one other thing that needs to be considered, too, is the issue of cabotage or reciprocity. If we have free and open markets, which foreign carriers can then enter by joining with our carriers financially, what do we get in return as a nation if our carriers cannot similarly enter foreign markets?

We do not have a national carrier, per se.

Senator McCAIN. Would you comment on Senator Ford's and my legislation—and that is probably an unfair question—that we introduced concerning this issue.

Mr. MEAD. No, we are not prepared to comment on that.

Incidentally, you mentioned the international issue, and that can be linked up very directly with the computer reservations system issue.

That is a major emerging issue—how are foreign owned CRSs going to interact with the CRSs that we have here in the United States?

Senator McCAIN. Well, Mr. Chairman, we have a series of very complex issues, and I think that the witnesses have provided us with a lot of good information and clarification.

I thank you, Mr. Chairman, and I apologize for the length of my questioning.

Senator FORD. I think the length is very excusable, Senator. As you say, we have some comprehensive problems if we are going to get into it. I worry about lots of things that we get into or should not get into as a government as it relates to business.

If we are going to say to some of these companies you have to break up and get out of the business and spread it around, and if you tell the department stores where one department store buys 1,000 shirts and another department buys 10,000 they will both pay the same price so that the little fellow entrepreneur out here will not be put out of business so he can sell them at the same price, that eliminates competition sometimes.

Senator Danforth.

Senator **Danforth**. Mr. Chairman, thank you very much.

Mr. Mead, I would like to say, as I did the last time you appeared before this committee, that I really appreciate the work you have done. I think that this is just first rate, and it is of enormous help to the committee and to Congress. It is highly professional, and I appreciate it. I think that you and your associates have every reason to be very proud of the quality of your work product.

Clearly, there is a problem. Let me ask you first, in general, how effective do you think we can be in solving it? Is this something that is worth the attention of Congress, or is this problem already in place and no matter what we do, it is just going to be fussing around with something that is already unwinnable?

Mr. **Mead**. I think the Congress, this committee and others have already been very effective and not just on this competition front. Let us look back over the last couple of years at some of the issues that this committee has had to come to grips with and its influence.

Senator Ford has kept the attention on the Aviation Trust Fund and FAA reform issues and, believe me, that is having an influence over there on the Secretary of Transportation and FAA. We see it in every facet of our work.

In competition, I think we have done a lot of educating of the public on what these issues are. I believe that we are beginning to home in on what some of the solutions are.

I do not think the debate really is any longer whether there is in fact a problem. I think the debate is exactly what do we do about it. That is a big step forward.

Senator **Danforth**. Do you believe that we can take steps that are effective, and not just tilting at windmills?

Mr. **Mead**. Yes. I hope that it does not come to a point where Congress itself has to enact specific rules.

I think you have in the Secretary of Transportation somebody who has expressed a willingness to move out forcefully in this area. Now I do not know what specific rules Mr. Skinner is going to propose, but I would hate to see the Congress deal with every facet of competition here and, in fact, take on the role of the administrative agency.

Senator **Danforth**. Now I would like to move on to the question of passenger facility charges. I take it that your position is, first of all, if we are going to have a future and if we are going to have competition, we have to have facilities. We have to build airports. We have to improve airports. We have to expand airports. We have to have more runways, more gates and the like.

Further, we need a financing mechanism to accomplish that which is not dependent on the good graces of the airline that already is in control of the airport.

Mr. **Mead**. Yes.

Senator **Danforth**. The advantage of a passenger facility charge is that it would be within the control of the airport, and, also, there would be a predictable source of revenue; right?

Mr. MEAD. That is exactly correct.

Senator DANFORTH. That way the airport authority will not be dependent on thumbs up or thumbs down from, say, TWA or whatever the airline is; and further, it would not be dependent on whatever the annual decision of an administration or Congress is relating to Airport Trust Fund use?

Mr. MEAD. That is correct. Even under the best of circumstances, the Federal Government is not going to finance 100 percent of the expansion of local airports across the country. I just do not see that happening, and I do not understand that any of the current pending legislation contemplates that.

So the point is local airport authorities will always need to foot part of the bill.

Senator DANFORTH. I favor this concept. I am not sure if Congress is of a mood to adopt such a thing right now, but I think we have to find some way, some mechanism for the local airport authorities to be able to expand without always having to go to someone else. Right now, the someone else sometimes has an interest in preventing expansion rather than encouraging it.

Mr. MEAD. I do not know if you have seen it, but yesterday the Airport Operators Council International gave testimony where they expressed their grave concern about the position of airport authorities in this country and the need for them to regain and reassert control over their own facilities.

Senator DANFORTH. This, to you, is an important component. It might not be politically possible right now, but it is an important component of the problem. It is something that clearly we should be focusing on.

Mr. MEAD. Yes. It is certainly one option. I do not know if it is realistic to tell the airports never sign majority-in-interest clauses anymore. The airport will say that is fine, but where am I going to get my financing.

Mr. WELLS. I think I would add to that that while we are not recommending that passenger facility charges be permitted, we think it is appropriate for the Congress to revisit this issue.

When passenger facility charges were outlawed in 1973, the airline industry, of course, was fully regulated by the CAB. You did not have dominated hubs the way you have today, and the financing situation of the airports was completely different. I think because the situation has changed, it is appropriate for the Congress to revisit this issue.

Senator DANFORTH. I could not agree more.

Let me ask you about the frequent flyer system. You mentioned that you dropped it. Is it your view that frequent flyer programs are anticompetitive but they are so popular that it is not possible for us to do anything about it; or, instead, is it your view that it is not particularly efficacious if we do something about it?

Mr. MEAD. Simply stated, what you said first. The intended purpose of frequent flyer programs is to enhance brand loyalty. All the major carriers have them. They pursue them vigorously. They are obviously having some effect or the airlines would not be so interested in them.

In a highly concentrated market, it makes sense that people are going to go to the frequent flyer program of the dominant carrier.

That is the one with more awards and that will tend to reinforce the dominance of that carrier.

I just do not know if it is reasonable to consider regulating them.

Senator **Danforth**. Let us suppose that we required that frequent flyer points be convertible into cash. Would that help fix the problem?

Mr. **Mead**. I do not want to be critical of your suggestion, but——

Senator **Danforth**. Go ahead. I thought it up just now.

Mr. **Mead**. That is almost on a par with the suggestion that they be transferable. When a frequent flyer cashes in his award now, it may cost the airline next to nothing when it is cashed in. Your proposal would enhance the value of the frequent flyer program so that the airline would actually have to pay some money.

Right now, unless a flight is otherwise fully booked, the passenger is flying for virtually nothing.

Senator **Danforth**. So you are saying that if we were to legislate such a thing, the airlines would not like it?

Mr. **Mead**. Yes.

Senator **Danforth**. That does not exactly send chills down my spine.

Clearly, it seems to me that if we have a problem of concentration, whatever we do some airlines will not like it. I mean, I can see the political problem with constituents of saying, hey, you have something that is popular now and you like taking trips to Paris, or whatever, on your frequent flyer points. Politicians do not want to be the bad guys to take this away from you.

Instead, if you were to say it has to be convertible into cash, that would seem to be less of a political problem, and let the airlines worry about it.

Senator **Ford**. The IRS then would enjoy it because right now they do not tax it.

Senator **Danforth**. They should be taxing it.

Senator **Ford**. I know, but they cannot find a way between business and personal, and they are in a quandary. If you turned it into cash, then the IRS would be in a position to tax it.

Mr. **Mead**. That is right. It would clearly be taxable if they were getting money for it, actual cash.

The problem is that it would be an administrative nightmare to tax.

Senator **Danforth**. That is a Finance Committee issue.

Other than the airlines not liking it, is there anything wrong with that idea? Would it help competition if you were to say it is transferable or convertible into cash?

Mr. **Wells**. Yes.

Senator **Danforth**. Would it be like toasters with the savings and loan associations?

Mr. **Noel**. What we want to do is to neutralize to some extent the advantage that the dominant carrier enjoys at a particular hub, and anything that you do that neutralizes that is advantageous.

Senator **Danforth**. Would it neutralize that advantage if that were done? I guess that is my point. Maybe people would clamor to use the dominant airline even more if they thought they were going to get cash rather than frequent flyer points.

Mr. **Noel**. I think the notion is it would neutralize it, because the airline would then say, gee, I do not think I want to do this anymore, and the practice would end altogether and it would cease to exist.

Mr. **Wells**. The problem with the system as it is structured now is you have to build up all of your miles on a single frequent flyer plan in order to earn a valuable award. If the miles were convertible into cash, then you could spread your miles over a number of different plans; that is, fly on a number of different airlines, get cash from all of them, and still get the same amount of award that you would if you concentrated your miles.

Senator **Danforth**. Why is this not a great idea?

Mr. **Wells**. The airlines would not like it, and they might drop the plans.

Senator **Danforth**. Good. That is what we want them to do.

Mr. **Wells**. We do not qualify for those plans anyway, so it makes no difference to us.

Senator **Danforth**. Let me ask you this. In your view, is the frequent flyer program concept a substantial component of our problem, or is that just a little piece of it?

Mr. **Mead**. If you believe what the travel agents are telling us, that business travelers more than half the time base their preference of flights on an airline based on their frequent flyer program, that is substantial.

Our information is that about 40 percent of the traveling public, including business, do not select their own flights, so frequent flyers would appear to be a fairly substantial issue.

Mr. **Noel**. I think the problem we have based upon the analysis we have done so far is that we cannot exactly quantify—of all these various barriers—what proportion this really accounts for.

Senator **Danforth**. Do you think it is a big one?

Mr. **Noel**. I think if it was not an important thing, the airlines would not do it.

Mr. **Mead**. I do not recall mentioning it before, but another approach to this is the Department of Transportation recently put out an information directive on the frequent flyer programs. That is good, and they will be getting a lot of information back on it.

Part of the problem with the frequent flyer program may be that people perceive these as being better than they really are. It may be that the DOT information they get pursuant to this directive will shed a lot more light on that. Part of this may be an education problem.

Mr. **Noel**. I was going to say one thing that would help here is that people somehow view these as a free lunch. I think, as we know, there are no free lunches. To some extent it is true that for the airline to provide that extra flight the marginal cost is very small because they may have that empty seat on the plane anyway; but that cost still is there, and it is being spread among all the passengers, and everybody is paying a little more for the benefit of having the frequent flyer.

Not everybody uses it. It is basically the heavy business travelers who get the benefits. If you are flying home because your mother is sick, you are not likely to accumulate the miles; yet, you are paying part of the cost of that.

Senator **Danforth**. May I ask just one more question?

Senator **Ford**. You can just keep right on.

Senator **Danforth**. Can you explain to me how the CRS system operates as a barrier to new entry? If I were thinking of becoming the Mr. Trump of the future and I was going to set up an airline, how would the CRS system be a barrier?

Mr. **Mead**. If you want to have people purchase tickets on your airline, they need a vehicle for purchasing the tickets. They go to a travel agent. The travel agent has a computer reservation service. It is one of the five that are out there. It is more likely to be the American Sabre system or the United Apollo system.

If the CRS books on your new airline, you will have to pay to, say, American Airlines a fee for each leg of the journey that is booked on your airline. That fee is paid to American by you, the entrant, and it would be about $2?

Mr. **Noel**. $2.10 per flight segment. So if you flew out through a hub to a final destination and then back, four flight segments, four times $2.10.

Mr. **Mead**. A second way is called incremental revenues. It seems that just the fact of having a particular airline CRS in place, the agents tend to favor that airline in its booking patterns. The Department of Transportation believes the figure to be between 10 and 15 percent of revenue, that would not otherwise have been obtained but for the airline having a CRS. In other words, those flights would have been booked somewhere else. That is called a halo effect.

It used to be worse. The CRS screen would have a bias on it. The flights of the airline that owned the CRS would show up first, and they have changed that. So the amount of incremental revenue has probably decreased somewhat.

Mr. **Wells**. So there is a substantial transfer of revenues between the airlines that do not own CRSs and the airlines that do. Last year we estimated that American and United each receive a net transfer of something like $300 million each from the other airlines in the industry, and this is in excess of their cost of providing the CRS service.

So if there is that kind of a transfer from one airline to another, it obviously disadvantages the airline that is on the debit end of the transfer.

Senator **Danforth**. Mr. Chairman, thank you very much, and thank you all very much.

Senator **Ford**. Thank you. I want to add my comments. I want to agree with the comments of my colleagues, Senator McCain and Senator Danforth, about the professional job you do.

You have helped us considerably in making some comprehensive decisions and we want you to continue in the same way. When we pose some of these questions that are hard questions, I have found that you have not backed away from them. Once you have made up your mind what you thought was the proper way to go, you stuck with it.

So I am very pleased with your testimony and very pleased with your work. I believe our work is only beginning in some of the things we are going to have to do.

The issue of CRS divestiture bothers me a little bit, particularly with the LBOs now, with foreign carriers moving in, and lots of other things. I find that the only leverage the Department of Transportation has over leveraged buy-outs, is the cancellation of the charter—the lifting of the certificate.

Other than that, all they can do is jawbone. We are getting ready to see some jawboning in the recent episode relating to Northwest. There will be some decisions made by the Department of Transportation on that proposal. We will then see if jawboning has any effect.

Otherwise, we think the department—at least, Senator McCain and I think that the Department of Transportation should be involved from the beginning, so that they could be a part of the process and have input and make a decision as you go along, instead of after the fact, after apparently the deal has been made and they are forced to jawbone. It is going to be awfully hard to back out after a deal is consummated, in my opinion.

So we see KLM with Northwest and Swissair with Delta, and Mr. Lorenzo at Texas and his apparent deal with SAS. If there is going to be a deal made hell, he is going to be in on it. So we have got all those foreign-carriers that are involved. I think, as we would say down home, this is about as clear as the middle of a blackberry pie.

We thank you very much, and we will be leaning on you, Mr. Mead, and your colleagues, in the months and weeks ahead. So I do thank you.

Mr. MEAD. Thank you, sir.

Senator FORD. The next witness is the Honorable Jeffrey Shane, Assistant Secretary for Policy and International Affairs, Department of Transportation. Mr. Shane, we welcome you and look forward to your testimony.

Mr. Shane, we ask that you recognize your colleagues and their positions with you. If you want to put in your full statement it will be placed in the record and you may highlight it, but that is entirely up to you and you may proceed.

STATEMENT OF JEFFREY N. SHANE, ASSISTANT SECRETARY FOR POLICY AND INTERNATIONAL AFFAIRS, DEPARTMENT OF TRANSPORTATION, ACCOMPANIED BY JAMES M. CRAUN, DEPUTY DIRECTOR, OFFICE OF AVIATION ANALYSIS; AND JOHN M. RODGERS, DIRECTOR, OFFICE OF AVIATION POLICY AND PLANS, FEDERAL AVIATION ADMINISTRATION

Mr. SHANE. Thank you very much, Mr. Chairman and members of the subcommittee. To my right is Mr. Jim Craun, who is the Deputy Director of the Department of Transportation's Office of Aviation Analysis, part of the Office of Policy. He has been very much in the vortex of our competition study, the study I will be outlining in a moment, and to my left is Mr. John Rodgers, who is the Director of the FAA's Office of Aviation Policy and Plans.

We have asked the FAA to participate in the competition study, particularly looking at the ground side and enroute capacity parts of the problem—airport facilities, slots, and some of the other things that I know members are interested in.

I will, Mr. Chairman, with your permission, read the full statement in the record.

The state of competition in the domestic airline industry has been a topic of particular interest to Secretary Skinner. As I am sure you are aware, the Secretary formed a task force to study the many facets of airline competition and to produce policy recommendations before the end of this year.

The approach of the task force has been to divide the work into manageable topics covering industry and route structure, pricing, airport and air traffic system capacity, airline marketing and distribution practices, primarily computer reservation systems, regional carriers, international competition, and ultimately an econometric model of the domestic industry.

The work on the various studies is being reviewed by representatives of other interested government agencies such as the Justice Department, the Federal Trade Commission and the Council of Economic Advisers. The studies are in various stages of completion, but several are well along in the review process, and as I say, we plan to have our study completed well before the end of this year.

Thus, it is important that my remarks today not be misinterpreted. I am not here today to express any departmental findings as such, with respect to competition. The complete picture must await the conclusion of our study, and I am sure that Secretary Skinner himself will want to share the Department's views with you at that time.

Nonetheless, given the timing of this hearing, I can report to you this morning on the preliminary results of at least two sections of the overall study: the part dealing with industry structure, and the part dealing with airport and airways capacity.

Previous studies, including the work of the GAO and others, have focused attention on specific problem areas, primarily pricing and service at concentrated connecting hubs. DOT's approach has been to step back and take what we think is a broader view, to study not just concentrated hubs, but service and price competition at all domestic points and in all types of domestic markets.

The objective has been to produce an overall assessment of the state of competition in the domestic airline industry against which our own analyses of problem areas could be judged in context.

Let me turn first, then, to the industry and route structure portion of the study. Much of the concern of the competitiveness of the airline industry has focused on the reduction in the number of airlines in recent years and the increase in the number of airports dominated by one or two carriers.

To be sure, increases in concentration at both the industry level and at many large hubs have been substantial. In 1988, the top ten airlines accounted for 94 percent of total domestic revenue passenger miles, compared with 78 percent in '84, and 85 percent in 1979.

In 1988, 90 percent of the industry's traffic—that is to say, in revenue passenger miles—was carried by only eight carriers, compared with 15 carriers in 1984 and 11 carriers in 1979.

The FAA classifies airports by size into large hub, medium hub, small hub and nonhub categories. At six large hub airports in 1988, 75 percent or more of the aircraft departures were by a single carrier. No large hub was as concentrated in 1984 or 1979.

But these kinds of figures by themselves, while not encouraging, tell only part of the story. While concentration has generally gone up at larger airports, the reverse seems to be true at many smaller airports. Thus, in 1979, only nine small hub airports had four or more carriers competing for the local market. By 1988, there were 32 small hubs with four or more competing carriers.

Senator FORD. Mr. Shane, I apologize for interrupting your statement, but would you give us what you call large, medium and small airports in size? Because four airlines going into a small hub indicates that there is more than just a community of 50,000.

Mr. SHANE. Mr. Rodgers is more familiar with those specific criteria.

Senator FORD. If you were going to refer to those in your statement, I thought we ought to define them.

Mr. RODGERS. Let me give you a point of reference. A large hub is a hub which enplanes 1 percent or more of the traffic in the Nation. Presently, we are enplaning about 400 million passengers a year. So a hub basically enplanes about 40 million passengers or more a year. Pardon me, 4 million or more passengers a year.

The medium would be—and I am stretching my memory—somewhere in the vicinity of about a quarter of a percent or more, up to a percent, and a small hub would be somewhere between .05 and a quarter of a percent.

Mr. SHANE. I would like to supply those figures for the record.

[The following information was subsequently received for the record:]

DEFINITION OF TERMS—LARGE, MEDIUM, AND SMALL HUBS

Individual communities fall into four hub classifications as determined by each community's percentage of the total enplaned revenue passengers in all services and all operations of U.S. certificated route air carriers within the 50 States, the District of Columbia, and other U.S. areas designated by the Federal Aviation Administration. Based on 426,816,045 enplaned revenue passengers in 1987, the percentage and number of enplaned passengers in the hub classifications for 12 months ending December 31, 1987, are:

Hub classification	Percent of total enplaned passengers	Number of enplaned passengers	Number of hubs
Large (L)	1.00 or more	4,268,160 or more	[1]28
Medium (M)	0.25 to 0.999	1,067,040 to 4,268,160	34
Small (S)	0.05 to 0.249	213,408 to 1,067,040	63

[1] Hubs are communities and, do in some cases, include more than one major air carrier airport; i.e., New York with Kennedy and La Guardia.

The 125 large, medium, and small hubs represented 26.2 percent of the 477 communities receiving air carrier service during 1987. The balance, 352 communities are classified as nonhubs (N) and each enplaned less than 0.05 percent or 213,408 enplaned passengers in 1987.

The 28 large hubs enplaned 316,041,613 (74.05%), the 34 medium hubs 70,646,403 (16.55%), and the 63 small hubs 30,300,604 (7.10%) in 1987. This accounted for 97.7 percent of total U.S. traffic.

This classification system was established by the Civil Aeronautics Board (CAB) with concurrence by the FAA. With the sunset of CAB, the Research and Special Programs Administration (RSPA) has maintained these definitions for, consistency in their record keeping.

Senator FORD. I wish you would do that. So we are talking about over 4 million, 4 million to a million, and a million to 250,000 passengers a year compared to my community of 50,000—you know, 2,000, 2,500 passengers a month is pretty good, and so we are talking about 50,000.

Mr. SHANE. That would not qualify as a small hub.

Senator FORD. But when you talk about large, medium and small, I wanted to know the size that you were talking about so we could compare.

Mr. SHANE. Another way of looking at it, Mr. Chairman, would be to point out that there is a universe of 57 of the small hub airports in the country, and nine of those 57 had four or more carriers in 1979; 32 out of the 57 had four or more carriers serving by 1988. So it is an indication of one area in which we have seen an increase in real competition, but at small hub airports and not at small airports by any other definition.

Just another indication, no nonhub airport had more than three competitors in 1979 and only 29 of them had three competitors. By 1988, 23 nonhubs had four or more competitors and 57 had three. I am talking there about small airports, and not small hub airports, which would be smaller than the small hubs that we talked about earlier.

A more meaningful measure of concentration, we think, is the level of competitive service at the city pair level. On a city pair market basis, concentration in 1988 was very similar to that to be enjoyed in 1984, and markedly lower than that we had in 1979. Let me explain that with some further examples.

In 1979, almost 70 percent of all passengers traveled in city pair markets where a single carrier accounted for 50 percent or more of total passengers. In both 1984 and 1988, the number of passengers in such markets dropped from 70 percent to about 50 percent. In 1988, more than half of the passengers traveled in markets with three or more competing airlines, compared with only 25 percent of the passengers in 1979.

The number of markets receiving nonstop service from two or more carriers was higher in 1988 than in 1979, although lower than in 1984. The total number of markets with nonstop service has not declined since 1984.

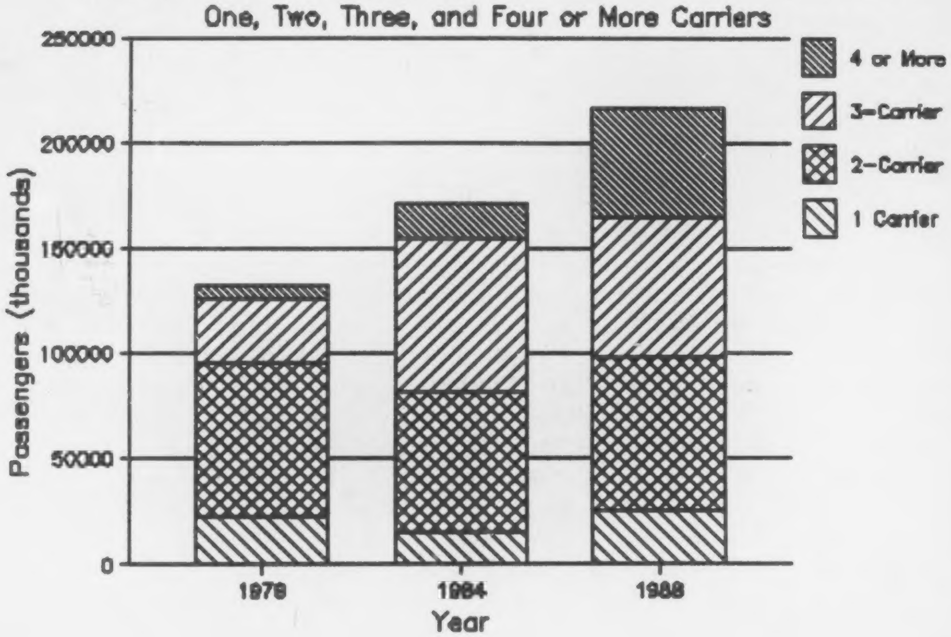
Finally, the number of markets receiving competitive single plane service in 1988 was in fact 25 percent higher than in 1979 and about the same as in 1984.

So the question is, how can we have such a great increase in concentration at the national level and at the larger hub airports, and at the same time have so much less concentration in individual city pair markets?

We think this apparent contradiction is explained by the geographic expansion of the major carriers and the integration of many new points that they serve through hub and spoke networks.

CHART 1

PASSENGER TRAVEL BY COMPETITIVE STATUS



While we have fewer carriers, in other words, most have experienced considerable growth and several have enjoyed phenomenal growth as they expand at the scope of their operations from a regional to a national basis.

In 1988, the ten largest carriers served all—or nearly all—of the 27 large hub airports and twice as many medium hubs, and almost three times as many small hubs, as they did in 1979, and that development stems in part from an attempt to control traffic through hubbing.

Hubbing provides a strong incentive for carriers to expand geographically, because they can cross-connect passengers at their hubs only if they provide service to the passengers' ultimate destinations. For example, when Piedmont elected to establish a hubbing center at Charlotte it was a "regional" carrier, with a service pattern focused mainly in the East. For Charlotte to succeed as a hubbing center, Piedmont had to, and did, expand service to major cities nationwide. Most other major carriers have matched this expansion of ocean to ocean and border to border route systems. So, while hubbing has resulted in high levels of concentration at the main connecting hubs, it has also greatly expanded the numbers of competitors in city-pair markets.

Simply measuring service concentration at a particular airport does not reflect the ways a hub-and-spoke operation at a concentrated hub airport intensifies service competition. Usually, airport concentration statistics do not distinguish between local passengers that travel to and from the hubbing airport on the one hand, and connecting passengers that move across the hub between other points, on the other. Most passengers at a hubbing airport fall into the latter category and they are typically able to enjoy competitive service from other carriers, often many other carriers, who offer connecting service from the same origins, to the same ultimate destinations, but over different connecting hubs. For these passengers, the fact that a particular connecting hub is dominated by a single carrier is of no consequence from the standpoint of enjoying access to competitive airline service.

There is an often expressed concern about hubbing as an operational strategy in that it produces a dominant service to smaller spoke cities where the hubbing carrier may be able to control both service and price. However, smaller points are, in fact, the greater beneficiaries of the hub-and-spoke system of operation. A small airport like Akron, Ohio, was in 1988 a monopoly *spoke* that was linked to Piedmont's connecting hub at Dayton. However, Akron was also a monopoly spoke for six other connecting hubs contributing to the dominance of one carrier at each of those hubs. Nevertheless, Akron as a result has available hundreds of connections to many points because it is a spoke city to each of these hubs. When Akron passengers move beyond one of the connecting hubs, many competitive alternatives are typically available. Most Akron passengers, in fact, do move beyond these connecting hubs. This is an example of how the hubbing process is a case of good news and bad news—it simultaneously increases concentration at a connecting hub, and creates competitive alternatives for passengers moving beyond the connecting hubs.

Before I leave the structure issue, I want to discuss further the "bad news" side of our study. While much of the increased hub concentration has resulted from adding service to new, smaller spoke points, not all concentration at connecting hubs is the result of new service. Concentration also results from decreased competition. In city-pair markets involving at least one concentration hub, very little nonstop competition now exists from carriers that do not hub at either end point of the city pair.

While non-hubbing carriers have sometimes been replaced by new hubbing carriers, they often have not. The result is fewer nonstop competitors in a number of large city-pair markets involving at least one concentrated connecting hub. Even where a non-hubbing carrier has been replaced by a hubbing carrier, this process causes concern because it seems to have locked in the carriers that will offer nonstop service in these large markets.

Other things being equal, expansion can be expected can be expected to involve the least risk for a carrier where that carrier already has a significant degree of concentration, and the most risk where another carrier already has a significant degree of concentration. This consideration is fundamental but profoundly important, because it would seem to encourage carriers to continue to expand by extending their dominance (that is, by entering new city-pair markets to and from their already-dominant hubs), or creating new areas of dominance, rather than by competing at other carriers' hubs. This strategy, which seems to prevail among the carriers operating today, strongly suggests that new entry in already concentrated city-pair markets will likely be the exception rather than the rule, and increases the prospect that the existing competitors will not compete vigorously over time.

If I may, I would like to turn now to the airport and airways capacity element of the study. As Secretary Skinner has noted many times, no major new airport has been built in this country since 1974. While traffic has roughly doubled since deregulation, airport capacity has remained stagnant. For competition to flourish, we must have more capacity and we must remove barriers to entry.

Four airports, as you know, are governed by the high-density rule, which allocates specific landing and takeoff slots to specific airlines. Allowing new entry presents a serious problem for any allocation program. To enter these markets, new entrants must depend on the vagaries of the occasional lottery of available slots in which they enjoy some preference, or must purchase or lease slots from current holders.

While this slot market has been effective in facilitating schedule adjustments for incumbent carriers, it has not been a particularly effective mechanism for encouraging new entry.

The Secretary is well aware of the imperfections in the current rules governing slot usage and has directed the Department and the FAA to develop ideas for changing those rules to create more opportunities, and specifically more opportunities for new competition at the high-density rule airports.

En route air traffic control delay was also studied as a potential source of barrier to entry. While certain en route sectors may be congested, it appears that there is generally adequate air space capacity within existing and planned air traffic control systems. Moreover, the cost of any delay is spread equally among those using the system, and so there is no discrimination, in any event, against new entrants in the system.

Thus, we see no barrier to entry associated with en route air space capacity itself.

Since ground-side facilities are an important factor in providing air transport services, we are also considering whether they can be a possible barrier to entry. In analyzing that question, we relied heavily on a survey conducted by the Airport Operators Council International in 1989.

The survey shows that gate availability is a problem that is a barrier to entry in both the short and the long-term. For example, of the 30 large hub airports that responded to the survey, 19 indicated that no gates could be made available within 90 days. And of the rest, only four airports indicated that five or more gates could be had within that period.

The reason that we use five gates is that we think five gates is about the minimum needed to operate a small hubbing operation at a new airport.

In the longer term, the lead time for construction of new permanent gates is well over two years, and certain provisions in the existing contractual arrangements between airport authorities and their current airline tenants, such as majority-in-interest clauses, we think can delay or prevent construction of new facilities.

So, to conclude, Mr. Chairman, significant work on the overall evaluation of competition has been done, but it has yet to be completed at the Department of Transportation.

We are finalizing a comprehensive pricing analysis that will include a larger database than previous studies have used. We are evaluating the effect of computer reservation systems on airline competition. It is also a particularly important component of our competition study.

In fact, our CRS rules, by law, have to be reviewed, and we just commenced a rule-making proceeding to determine whether, and in what ways, the present CRS rules ought to be modified.

As you know, the Department, under Secretary Skinner, has endeavored to promote competition whenever the opportunity to do so has come along. Thus, the Secretary wrote a letter to the Attorney General on two different occasions; first, opposing the sale of gates at Philadelphia by Eastern to US Air, and again in opposition to the merger of American and Delta's computer reservation systems.

The Department of Justice subsequently announced its opposition to both of those transactions and neither of them took place.

The Secretary, as you know, has also taken a very active interest regarding leveraged buy-outs and the control of U.S. airlines through foreign investment, subjects that have come up earlier today, and has emphasized the Department's role in assuring that the transfer of international route authority does not result in less competition or reduced service benefits.

We will continue to monitor closely the activities associated with the Eastern bankruptcy for its competitive implications.

The study of industry competition initiated by Secretary Skinner is very broad. He is committed to doing everything he can to preserve and enhance competition in our deregulated airline environment.

And I would be very happy now to answer any questions that you may have. Thank you very much.

Senator Ford. Thank you, Mr. Shane.

How many major airlines were in business in 1979?

Mr. Shane. I do not have the exact number, Mr. Chairman, at my fingertips.

Senator Ford. Well, you talk about more competition; it is like the steel industry, because of international competition they have closed down their plants, plant after plant. Then they now say that they are at 84 percent capacity. Eighty-four percent capacity of what? That is the present day, reduced from 10 years ago.

Now you are saying that there are more airlines; and really there are fewer airlines in competition; they have all been bought out or purchased.

Mr. **SHANE**. No, the burden of my testimony, Mr. Chairman, is that, in fact, there has been a reduction in the number of players. On an industry-wide basis, there is not any doubt that we are dealing with a smaller universe of airlines.

Senator **FORD**. Well, you have a smaller number of airlines that can be competitive in smaller communities or smaller hubs; is that not right? Or smaller airports?

Mr. **SHANE**. There are two kinds of city-pair markets that we have to distinguish between. The airports which are linked up to a dominant hub undoubtedly have less competition, because they are dominated by the carrier that operates out of that hub.

But the city-pair market which does not involve transportation to or from a dominant hub is likely to enjoy more competition today, and this is what I described as the counter-intuitive part of our results, than they did in 1979.

That is the good news, if you will, in a good news-bad news story.

Senator **FORD**. Well, there is only one airport I can fly to out of my hometown that is not a hub. You know, if I do not go through a hub, I do not go through anyplace. I either fly over them or do not get to go.

Mr. **SHANE**. That is right, sir.

Senator **FORD**. So, you know, it is very difficult for some of us out there in the hinterlands to understand your phraseology or how the city routes and competition is just not there.

Mr. **SHANE**. Well, surely, it is a function of where you live. And there is not any doubt that for people that live in communities that are served by a linkage to a major hub, you are precisely right: there will be less competition. We are not trying to gainsay that.

What we are pointing out is that there are a surprising number of passengers out there moving in other city-pair markets, living in relatively small communities that are, yes, hooked up to one particular hub for one airline's purposes, but have access to a lot of other hubs for going beyond the hub to another secondary city.

Senator **FORD**. Well, Mr. Secretary, you fly to Louisville or to Lexington, and then after you have made those two trips, you come back and tell me how you got there.

Now you talked about new airports; that is one of the problems, facilities. How hard are you all fighting to get the money out of the trust fund that has now almost a $7 billion surplus? What is your proposal to the administration to turn that money loose?

That money is based on an 8 percent tax; and you are taxing people and not spending it. It is beginning to grate on a lot of people that you have not built a new airport. You have got one on the books that is going to take a lot of money and yet we see this $7 billion continue to build and we do not see you kicking and screaming trying to get the money out to those people that really need it.

Mr. **SHANE**. Well, I know that there has been a long debate about the trust fund. I prefer to focus on where the aspirations are. I mean the fact is that until very recently, nobody has been clamoring for money from the trust fund to build a new airport.

In fact, I think Secretary Skinner feels like he is a bit of a promoter. He has been beating the drum to generate some interest in the construction of new airports and addition of real capacity to the airport and airway system in the United States.

Senator FORD. Well, you know, those are out there, it is just those that are there trying to get along. You say, well, we will forget about those, we are going out to beat the drums for new airports. There are also those that are there that are trying to expand and do a tremendous job, and they look up here and see $7 billion in surplus and they cannot get their hands on it.

I even got a little amendment on a couple of years ago that said you could go ahead and spend your own money, then apply to the FAA and eventually get your money reimbursed. That was one way we tried to help airports spend their own money to offset what the government is not doing that they should be doing.

Mr. SHANE. Well, I am sure you are familiar with all of the arguments that you have heard from the executive branch before. We are spending a lot of money on the aviation system. We spend more money out of the general treasury than we have not spent out of the trust fund.

And the fact is, there is a penalty provision applicable to the use of the trust fund, and I have not looked at the numbers in the past month, but the last time I looked at them it seemed like the entire surplus in the trust fund could be directly attributed to the operation of the penalty provision.

I think we have spent more money, in total, out of the trust fund, plus the general treasury, than the trust fund would ever have had available to the United States by itself.

So it seems to me that it is not entirely fair to charge the executive branch with not paying enough attention to the aviation system. I think we have done more than was expected from the trust fund.

Senator FORD. Well, you cannot say that you have been out beating the drum to improve other airports. You know, if you are out beating the drum for new ones, that is fine, trying to spend that money, that is one thing. If the administration is not going to authorize that money or they are going to veto it if the bill comes up there, I do not care how big a drum you have to beat, you are not going to have any money. That $7 billion is going to stay there.

Mr. SHANE. I have been traveling all over the country, Senator, in the context of——

Senator FORD. Obviously, not to Louisville or to Lexington, but all over the country.

Mr. SHANE. You would be surprised.

Senator FORD. Well, when you come, let me know. We will have a deep carpet for you to step on.

Mr. SHANE. Absolutely, sir.

I have been traveling in the context of what the Department of Transportation is doing on the national transportation policy front. And the issue of airport construction is always a very hotly debated issue at the local level everywhere I have been.

There is a tremendous tension between those at the local level who want more airport capacity and those who do not. It is a fascinating dynamic to watch. And I have a feeling that if there were more of a concerted effort at the local and regional level to come at the Federal Government demanding more money for the expansion facilities, it would be a very different kind of dialogue.

But the fact is, we just have not had that kind of demand.

It has been a federal question, rather than a local and regional question. And what we would like to see is more of a demand for airport facilities.

Senator **Ford**. Both of us are going to get on you, Mr. Shane, because you are dead wrong, absolutely dead wrong about competition for monies for airports and airport expansion. If you do not think that it is out there, you are going to sleep over there in the department or you have gone someplace else. Because there is an overwhelming desire.

Go out and talk to these airport executives. Get their input. Ask them what they need and what their capacity problems are.

Mr. **Shane**. The airport executives are right there. They are always right there, but they fight battles at the local level. And it may not be that——

Senator **Ford**. Where is this thing built, Mr. Shane? It is not built up here. They are built at the local level; they are built at the grassroots level. They are the people that have to face the paying off of the bonds, dealing with the airports, trying to organize something so that their local airport board can make a go of it.

And yet you say they are not scrambling and do not want it?

Mr. **Shane**. No, the people responsible for the airport facilities are scrambling. That is my point. But what I am saying, I have been in Texas, for example. We spent a whole week down there.

Senator **Ford**. Well, you can land in Texas anywhere you want to; it is just a lot of gravel, flat land. We do not have that.

Mr. **Shane**. Well, the folks that are running DFW feel that they need a runway very badly.

Senator **Ford**. Well, we have got two in Louisville we would like to have.

Go ahead, John, I am for you.

Mr. **Shane**. My point is that they cannot build that runway because they do not have the local consensus that they need right now. They have to solve a local problem before they make an application to us. And that has been the controversy.

Senator **McCain**. Mr. Shane, I think your point is valid that there is some local opposition, particularly by people who live near an airport, because of the noise problem. But I think there is a total realization across this nation that air transportation is the key to economic success in America.

And yes, there are times and places where there is an inability to build consensus; you just mentioned Dallas-Fort Worth as an example. There is also a very fascinating experiment going on right there where Ross Perot is building an airport.

Mr. **Shane**. That is right.

Senator **McCain**. And so there may be local opposition to another runway in Dallas-Fort Worth, but there sure as heck is an incredible conviction and belief, because of the experiment that they had with Dallas-Fort Worth Airport, that they need to have more runways and more airports.

And I would suggest to you that most of these problems will be solved in the future as we start to use quieter aircraft.

I hate to take the time of the chairman, but let me just reemphasize, Mr. Shane, that there is no logic, or rhyme or reason to this. And I place a great deal of the blame on our friends who are on the appropriations committee and the budget committee, who have to try to meet the Gramm-Rudman targets. We are not blameless here in Congress.

I think someone has misread the situation if they think it is not controversial, and not a cause of anger out there, that we have collected $8 billion in taxes and then not spent it.

And I think that it would be incredibly helpful and important, as the chairman said, for the administration to join us in this effort of trying to spring this money loose. We should not let the Office of Management and Budget drive every single decision that is made in whatever department of Congress we are discussing, which seems to have happened lately.

I would be glad to hear your comments. And I thank you, Mr. Chairman.

Mr. SHANE. The only comment I would have is that I would not want the hearing to end with the suggestion that we are of different views about the need for more airport capacity. I think it would be unfortunate if our joint conviction that we need more airport capacity were lost in an argument about one particular mechanism.

In fact, you know we are in a dialogue with you right now about what the status of the FAA ought to be. In the context of that examination, we are looking at the funding of airports and other mechanisms. We hope that we are going to be able to find a mechanism that works without getting into this annual crisis over exactly how much money in the trust fund will be available.

There is not any difference of opinion about the importance of new facilities. And if anybody has made it a banner issue, it is Secretary Skinner.

Senator FORD. Mr. Shane, one, the budget starts with the executive, regardless of what we do. And you have a great deal of influence. A president, they say, does not have much influence, as long as he does not control the Congress, but if you have a wet pen and a third of the votes, you can do anything in this town you want to do.

So I understand that very well.

Your capacity problem is not going to be addressed until you address the surplus. That is my judgment. If you do not address the surplus, then why, you know? Are we just going to take what is left? Are you going to leave it in there?

I have got a little gimmick in my S. 1600. I think maybe we can do everything but independence in there. And you keep on not understanding what is going on, I might get a little more support for independence.

Let me also ask you this. On April the 20th, 1989, Senator Hollings, chairman, Senator Danforth, the ranking member, Senator McCain, the ranking member of this committee, and myself, sent a letter to Secretary Skinner on airline deregulation and competition, along with a series of questions on a number of policy issues related to industry competition. It has now been five months, Mr. Shane, and if you have not been flying to Louisville or Lexington, you ought to have some time to help the secretary answer that letter.

Can you tell us why we have not received an answer? Or do you have the answers to give us this morning?

Mr. SHANE. I do not know why the letter was not answered. I am surprised to hear that it was not answered, Senator.

I am just going to have to check on that and find out what the reason is.[1]

Senator FORD. Well, do you think maybe you can do it in another month?

Mr. SHANE. Well, if you want complete answers on airline competition, as I have indicated, I would encourage the Senate to wait until the study is done.

Senator FORD. Mr. Shane, we are getting awful tired of waiting for studies. You know, it is study this, study that, I have got these looking at this; that is a way of delay, in my opinion. You are going to delay so long we are going to go ahead and do something. We would like to do it with your cooperation, rather than your opposition.

Mr. SHANE. You may have our cooperation.

Senator FORD. I know, but we have got to wait until the study is in. Now that will be next year. We are facing some real problems right now in the real world.

Mr. SHANE. We are dealing with a fast-changing industry, Mr. Chairman.

Senator FORD. Yes, and some of us are still driving a horse and wagon trying to hold the thing together. We need a lot of new technology. We need a lot of help. You need to frame it in a way that you can add on to it, and stay up with the fast-moving, changing industry. We are just not doing that.

We are not looking at a computer system, for instance, that will take care of us for the long-term; that all we have to do is add on. I do not know too much about computers, but I do know that if you get the right kind you can continue to add on to it.

What we need is a direction as it relates to airport capacity and competition. Once we make a decision, we can go ahead and phase it in over the long haul. But now we are just studying the damn thing to death.

Mr. SHANE. With all due respect, Mr. Chairman——

Senator FORD. You do not have to have any respect at all. Do not just sit there and say we are going to get to it later.

Mr. SHANE. I did not expect to argue with you because I had the feeling we were all on the same wavelength when it came to airline competition.

Quite simply, there has not been——

Senator FORD. Well, we were singing out of the same hymnbook in here yesterday, and I begin to worry about the church that we were all going to as it relates to the DC–10s after the report yesterday afternoon. And so, let us not all get on the same wavelength. Let us try and defend a position and then come to an agreement. That is what I would like to do, but do it. That is the frustration we have.

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[1] See p. 72.

I am going to turn it over to my friend, Senator McCain.

Senator McCAIN. Thank you, Mr. Chairman.

Mr. Shane, thank you. One of the aspects of your confirmation hearing was that you assured this committee that you would be candid and forthcoming in your responses, and I appreciate that.

I believe also in your confirmation hearing you were asked about the trust fund, and I think at that time you said that you would do whatever you could to try and see that those monies were made available, and I hope you will continue in that.

Let me go back to basic philosophy, particularly since you stated that we are on the same "wavelength." Is it your belief that the airline industry in America today is becoming more anti-competitive?

Mr. SHANE. On the basis of what we have seen to date, it is more anti-competitive at large concentrated hubs.

Senator McCAIN. Do you believe that the trend is in the wrong direction as well?

Mr. SHANE. Only at those airports.

As I say, quite contrary to our expectations, there are more travelers today moving in airports in city markets, city pair markets, that have more competition than there are in the large concentrated anti-competitive circumstances.

Senator McCAIN. Well, then, you and I are on two different wavelengths. You have just indicated the single exception to what I see as an increasingly concentrated and anti-competitive market. I could provide you with a list of 20 factors that, in my view, clearly indicate a trend toward de facto reregulation and a failure, or a decreasing inability, for small airlines to compete with larger ones. And so, we are not on the same wavelength.

Let me now focus in on one issue that you heard discussed with the GAO, and that is the CRS. I understand that yesterday you issued some new rules concerning——

Mr. SHANE. Not rules, an advance notice of proposed rule making asking a lot of questions about the present rules.

Senator McCAIN. Do you believe that divestiture of CRS is an avenue that should be explored?

Mr. SHANE. I would have no objection to exploring it. I start from the proposition that divestiture is probably not a necessary remedy.

Senator McCAIN. In retrospect would you agree or disagree with some of the mergers that were approved of during the last administration?

Mr. SHANE. If, in fact, at the end of the study we have seen too much concentration and that concentration at particular hubs can be attributed to a merger that was approved here or there, then I would probably have to concede that we would have been better off not to have allowed that particular concentration to take place.

I would like to reserve judgement until we have all of the facts before us.

Senator McCAIN. And again, when is that study anticipated?

Mr. **Shane**. In a couple of months, before the end of the year is what Secretary Skinner has required.

I do not know whether that goes to the question of whether the mergers should have happened. A lot of those mergers were, in fact, end-to-end mergers that had sone anti-competitive element, and it is really the anti-competitive element that you are focused on and that I think just requires a little more factual analysis before we can draw a conclusion.

Senator **McCain**. Well, I guess we could engage in this discussion at great length, but I want to emphasize again that almost every factor—not every factor—I see which is an indicator of whether the industry is becoming more or less competitive, clearly indicates to me that the airline industry is becoming less competitive.

We are seeing more and more concentration at hubs; more and more airports are becoming slot-limited; and we are seeing CRS systems, and frequent flier systems that clearly favor the major airlines. I think these should be matters of concern, and I would hope that you would address these as we get into the study.

I did not even talk about the two other issues which recently emerged—and those are the leveraged buy-outs and their effect on an airline's ability to compete internationally, and also, of course, the foreign investment that we see in airlines which could lead to less competitive marketing agreements over time.

But we have one more witness, and I thank the chairman and I thank you, Mr. Shane.

Would you care to comment?

Mr. **Shane**. Just one comment, Senator McCain. I emphasized what I thought was the one element in the structure, part of our study that I thought was surprising, and I am getting the impression, that, my emphasis on that one surprising element suggests that we think there is nothing but good news out there. That is not the case.

All of the mechanisms that you described that do appear to have anti-competitive implications for the airline industry are very much before us. They are very much of concern. Those elements have not yet been completely studied. They will be studied as part of what we do complete before the end of the year, and I can promise you that there is nothing that we are trying to skim over or whitewash.

If there are anti-competitive elements out there—and we certainly see evidence of some diminishing competition at large hub airports—then we have a challenge, and we have every intention to meet that challenge.

And I just did not mean to suggest that we were comfortable with the state of competition of the airline industry.

Senator **McCain**. Thank you.

Thank you again, Mr. Chairman.

Senator **Ford**. Senator Exon.

Senator **Exon**. Thank you very much, Mr. Chairman.

Mr. Shane, one of the concerns that was expressed and discussed a great deal when we had airline deregulation was the concern for the monopolization of the major hubs. As it has turned out, that was a legitimate concern. Would you agree?

Mr. **Shane**. Yes, sir.

Senator EXON. With regard to the trust fund, I listened with great interest where you indicated that there had been more money used out of the general fund rather than tapping the trust fund for airport construction, is that correct?

Mr. SHANE. Yes.

Senator EXON. With the trust fund and the dedicated purpose of that trust fund, which is funded through an 8 percent passenger ticket tax, why tap the general fund? I ask that particularly when we have that money built up for the people that use the services of most airports? That does not quite make sense to me. Is there a reason for that?

Mr. SHANE. The programmatic decisions, I guess, that are being made in the FAA require the use of monies for purposes that the trust fund monies were not eligible for. It became, I think, a choice of either shortchanging the aviation system because trust fund monies were, by virtue of the rules governing the trust fund, not available for the expenditures that were needed, or going to the general treasury and making sure that we did not shortchange the aviation system.

Senator EXON. Are you suggesting that possibly we should broaden the authority for the use of the trust fund?

Mr. SHANE. We think that the aviation system includes a lot of different facets, including the running of the FAA, the running of the air traffic control system, and the very severe limitations on the use of trust fund monies for those purposes, I think, has gotten in the way of us making good on our promise to the American public that that 8 percent ticket tax is going to be used for aviation.

Senator EXON. Of course, here is a place where I think the administration is reversing the intent of the Congress, Mr. Shane. The trust fund was basically set up for capital development. Maybe there were too many restrictions on it. It was set up to meet the needs that we in this committee have been talking about for basic construction of better facilities and better runways.

I think the Congress clearly indicated that for these other purposes, to run the FAA or the other expenses therewith connected, that we should tap the general fund.

The net result, it seems to me to be—and I am wondering if you would agree, that there is considerably less total money being expended through a combination of the trust fund and the tapping of the general funds than either the Congress or the administration at the time of deregulation intended.

Mr. SHANE. Well, there has not been any effort at all by the administration to reverse the intent of Congress. It is living within the intent of Congress, I think, that has forced us into the general fund. We are not taking anything out of the trust fund that was not eligible to be taken out of the trust fund, if I understand the question.

Senator EXON. Do you think this administration and previous administrations have followed the will of Congress by allowing an excessive amount of money to accrue in the trust fund?

Mr. SHANE. We are talking about, I think, a constitutional question.

Senator EXON. No, I am talking about a policy question.

Mr. **Shane**. The intent of Congress, as I understood it, was to collect monies through a ticket tax that would go into a trust fund that would be available for airport construction in the main.

Senator **Exon**. Well, it is available but it is not being expended for that purpose.

Mr. **Shane**. I guess I am having trouble understanding how Congress could intend a particular amount of money to be in the trust fund without knowing how many passengers would be flying.

Senator **Exon**. We anticipated on a general basis what was going to happen. That has happened. There have been more people flying. We anticipated the need for that, and we said to the traveling public you are going to pay 8 percent on every ticket that you buy, and the money goes into the trust fund. But the end result has been continual expansion of the trust fund without the expenditures.

If we follow your line of reasoning, would it not be wise then for us to either eliminate the 8 percent tax that the traveler is paying today for his airline ticket? Is that an option you would recommend?

Mr. **Shane**. Well, Senator Exon, as I said in response to an earlier question which you may not have been here to hear, we are taking a look at the whole variety of mechanisms that might be recommended for airport financing right now.

We have been in an argument, the two branches of government, for a long time about whether the trust fund is being used for its intended purpose, whether it is being used properly, and whether it was properly created in the first instance.

We think the time is now to get on with the business of finding mechanisms that do work that do not involve us in this crisis every time the budget cycle comes around because it clearly has been a source of nothing but dissention between the Congress and the executive branch.

There is not any difference of opinion about the need for new airport capacity. I said earlier it provoked quite a reaction from the subcommittee that—or from the chair in particular—that we are looking for—and this may sound again counterintuitive—greater enthusiasm or at least a greater conviction at the local level based on consensus that there needs to be new airports, and we are not seeing those presented.

The applications for those kinds of facilities are not coming in.

Senator **Exon**. Well, Mr. Shane, I was here and I heard the exchange. The only time I was out of this room this morning was when I had to go over to the Armed Services Committee. We had a very important matter going on over there today with the testimony from the new Chairman of the Joint Chiefs.

I think I heard most of the important testimony, and I certainly heard the testimony that you just referred to that caused mild concern by our Chairman.

I share that because you are sitting here telling us that these trust funds are there, they are available. You just have not been able to find anybody who wants to use them, and that certainly is not what we hear. But we are not going to get an answer from you on that.

Let me ask you this question. I think that we have established pretty well with previous witnesses and I believe pretty much from your opening testimony that we do indeed have a problem—especially at hub airports—because of a lack of competition. Is that true?

Mr. SHANE. Yes, sir, at the larger hub airports in particular.

Senator EXON. That is what I said. And the administration shares our concern in that area. What would you feel would be—what are the number one and number two problems in your view with regard to lack of competition at large hub airports?

Mr. SHANE. At the high-density airports which have the slot rule in effect, I would say it is the unavailability of slots. There simply cannot be new entry.

I mean, there can be some marginal new entry to the extent that somebody divests themselves of some slots or in the case of Eastern, you know, they were not using some slots for a while, and so we had a quick lottery to make some available on a temporary basis. But it is very difficult for a new entry to come in on the basis of that kind of opportunity and really make a presence felt.

So, at those airports—we are talking about the four that are governed by the high density rule—I would say slots at those airports and other airports, even those not governed by the high density rule, increasingly are a problem. Also, I think ground site facilities are getting to be a very serious problem, just the availability of gates.

That AOCI study that I referred to earlier was troublesome by disclosing that you had to look long and hard to find an airport that could make as many as five gates available that were not already being bottled up by an incumbent carrier in order to support meaningful new entry. That is coming back to the capacity question again.

Senator EXON. We could use a trust fund, could we not, for gates?

Mr. SHANE. Yes, sir.

Senator EXON. Well, there in your own testimony you indicated a shortage that maybe could be addressed.

I will not take any more time except one last question. I am a member of the Budget Committee, and we continue to wrestle with these problems. Supposing we put off budget the trust fund, the airport trust fund so that it could not be counted to falsify the annual deficit. Do you think that would be a sound move and does the administration support that?

Mr. SHANE. I would prefer to get back to the record with an answer to a question like that, Senator.

[The following information was subsequently received for the record:]

The Administration does not support taking the Airport and Airway Trust Fund off budget. Removal of the trust fund from the unified budget would make it more difficult for Congress and the Executive Branch to account for the true size and financing of federal programs, and to deal meaningfully with the problems of the budget deficit. Despite common perceptions to the contrary, the aviation programs have been contributing to the federal deficit. Between FY 1982 and 1989, $20 billion was collected in trust fund revenues while a total of $39 billion was made available for spending by the Federal Aviation Administration. We are committed to seeing that aviation user fees are spent for the purposes for which they were collected.

Senator **Exon**. I anticipated that might well be your answer, and I understand. I have no further questions. Thank you.

Senator **Ford**. Thank you, Senator Exon.

Mr. Shane, let me just say to you, you have created today a generation of mail, and I hope that you are better at answering those people out there that want to improve their airports than you have in telling me that there is no competition out there.

So, I look forward to the improvement in the collection of the stamp money by the Postal Service as your mail increases in the near future. If you find that there is no competition for funds, I think maybe that that statement—and I may be wrong—I am not going down to the office and start making calls and say start writing letters, but I suspect that you will receive a great deal of requests, and we would like to have them all directed to you personally.

Well, you have made my day, Mr. Shane. I feel much better about it. Yesterday was so quiet and sedate that I did not have any fun at all.

Did you have another statement you wanted to make, Mr. Shane? Your new information there, is that something you wanted to share?

Mr. **Shane**. This is, in fact, a copy of the answer that Secretary Skinner sent to you, Senator, in May of this year in response to the letter that you referred to earlier.

It is predictably an answer that says we are studying it.

And maybe you did not think that was a real answer, but we are studying it, sir, and we really do intend to get you a meaningful answer within the next few months.

Senator **Ford**. Well, the next few months. That means by January. In the meantime, the next Congress starts and maybe you might have an answer for me. We will get you an answer that we are studying it. I read all those and probably have written several of them.

But I know the difference. Thank you, Mr. Shane and Mr. Crawn and Mr. Rodgers. We thank you all for coming today, and we look forward to you coming again.

Mr. **Shane**. Thanks very much.

Senator **Ford**. The next witness will be the Honorable James F. Rill, Assistant Attorney General, Antitrust Division, Department of Justice.

Mr. Rill, we were advised that a vote would come at 11:38, and I was hoping that we might go vote before we take yours, but apparently that has been postponed and so we will entertain your statement and look forward to a questioning period after that, so, you may proceed.

If you wish to submit your statement in the record in toto and highlight it, it is your prerogative.

STATEMENT OF JAMES F. RILL, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. **Rill**. Thank you very much, Mr. Chairman, Senator Exon. I would like to have my statement included in the record if there is no objection.

Senator FORD. Without objection, your total statement will be included in the record.

Mr. RILL. And what I will undertake to do is summarize it at this point.

I am pleased to have the opportunity to appear today to discuss competition in the airline industry and what we believe is the important role that the Department of Justice plays in preserving and protecting that competition. A vigorously competitive transportation infrastructure is crucial to the health and vitality of the U.S. economy.

The Department of Justice has long taken an active role in protecting the public from an unreasonable restraint of trade in the transportation sector, and in our statement we cite some cases in which the Department of Justice has undertaken that program.

You can be assured that the antitrust laws will be vigorously enforced with respect to the airline industry and all other industries during my tenure as head of the antitrust division.

With some qualifications, the antitrust laws have always applied to the airline industry, and the Department of Justice has brought enforcement action under those laws when warranted.

It is and it has always been a criminal antitrust violation for competing air carriers to agree on the fares they will charge on routes which they serve.

Let me assure you that when we have reason to believe that this kind of conduct may have occurred, we intend to bring the full arsenal available under the Sherman Act to bear on that practice.

As a result of the Airline Deregulation Act of 1978, we have been and expect to continue to be more active in civil litigation in the airline industry with the expiration of the Department of Transportation's authority over mergers, acquisitions and inter-carrier agreements concerning domestic air transportation, airlines have become subject to essentially the same antitrust rules that govern other American industries.

Therefore, airline mergers that violate section 7 of the Clayton Act or sections 1 and 2 of the Sherman Act will now be challenged in courts by the Department of Justice.

As in other industries, the central issue will be whether the merger results in increased prices or may result in increased prices to consumers by creating, enhancing or facilitating the exercise of market power by the resulting firms.

Because the department's work in the airline industry has been most extensive in connection with our review of proposed mergers and acquisitions, I would like to focus my remarks today on that particular area of antitrust enforcement.

Senator FORD. We do have our vote, Mr. Rill, and what we might do to save both of us some inconvenience and if you will be so kind as to let us submit questions to you and you would be able to answer those in writing and say you would have ten days to two weeks, would that be objectionable?

Mr. RILL. That is perfectly agreeable, Mr. Chairman. I can do whatever you see fit.

Senator FORD. I apologize. I thought we were going to make it this morning.

Mr. **Rill**. That is perfectly all right. If I can just have two minutes and summarize.

Senator **Ford**. When the five lights come on, I am gone.

Mr. **Rill**. And then I will be very lonely here, so I guess I will try and do it as quickly as I can.

We intend to apply the merger guidelines in evaluating mergers and acquisitions in the airline industry.

In doing that we intend to look initially at the level of concentration at major hubs. The only factor, the principal factor that we think is likely potentially to overcome any presumption from concentration is the question of entry.

While deregulation, we think, has by and large operated to the benefit of the consumer, it has also contributed in part to conditions in the airline industry which have enhanced efficiency, but also we think elevated barriers to entry over and above what they might have been otherwise, and particularly what some economists might have thought existed in the airline industry.

We think mistakes have been made. We intend to look very, very rigorously at not only acquisitions of airlines, but also acquisitions on facilities that could create barriers to entry, including acquisitions of slots and acquisitions of gates.

We welcome the Department of Transportation's rule-making proceeding that intends to look at, among other things, the computer reservations system. Well, that system, I think, has enhanced efficiency and, therefore, competition in many respects. I think it is undoubtedly true that that system has elevated barriers to entry in some respects.

In conclusion, our nation's airline industry has gone through a tremendous change in recent years. To a large extent, consumers have been the beneficiary to preserve and secure the benefits of airline deregulation, and the antitrust laws must be vigorously enforced to ensure that consumers are protected against unreasonable restraints of trade and from mergers or other transactions that could lead to the exercise of market power.

[The statement and questions and answers follow:]

STATEMENT OF JAMES F. RILL, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. Chairman and Members of the Subcommittee:

I am pleased to have this opportunity to appear here today to discuss competition in the airline industry, and the important role that the Department of Justice plays in preserving and promoting that competition. A vigorously competitive transportation infrastructure is crucial to the health and vitality of the U.S. economy, and the Department of Justice has long taken an active role in protecting the public from unreasonable restraints of trade in the transportation sector. You can be assured that the antitrust laws will be vigorously enforced with respect to the airline industry -- and all other industries -- during my tenure as head of the Antitrust Division.

With some qualifications, the antitrust laws have always applied to the airline industry, and the Department of Justice has brought enforcement actions under those laws when warranted. 1/ Absent immunity, it is -- and has always

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1/ *See*, *e.g.*, *United States v. Pan American Airways, et al.*, D.D.C. Crim. No. 77-73, filed February 3, 1977 (price fixing of military fares); *United States v. Braniff Airways, Inc. and Texas International Airlines, Inc.*, Crim. No. SA-77-CR-164, W.D. Tex., filed August 16, 1977 (monopolization); *United States v. American Airlines and Robert Crandall*, CA3-83-0325-D, N.D. Tex., filed February 23, 1983 (attempted monopolization); and *United States v. Air Florida, Inc., et al.*, D.D.C. Crim. No. 84-260, filed July 11, 1984 (price fixing of non-IATA fares).

been -- a criminal antitrust violation for competing air carriers to agree on the fares they will charge or on the routes they will serve. Let me assure you that when we have reason to believe that this kind of conduct may have occurred, we will bring our full criminal investigatory arsenal to bear. In this and in other industries we will seek stiff jail sentences and fines for officials who are responsible for the criminal activity. Thus, the airline industry should take our general record of criminal prosecution as a serious warning against engaging in activity that is so clearly harmful to consumers.

As a result of the Airline Deregulation Act of 1978, we have been and expect to continue to be more active in civil litigation in the airline industry. Economic regulation of domestic aviation has been virtually eliminated. Entry, exit, fare, and service decisions were subjected to the rigors of the marketplace, and the Civil Aeronautics Board (CAB) was abolished as of January 1, 1985. Regulatory oversight of mergers and agreements between carriers was retained and transferred to the Department of Transportation (DOT), which was authorized to grant antitrust immunity for approved transactions. While the industry was still regulated, the Department devoted some of its scarce resources to the regulatory arena in order to promote regulatory policies and decisions that would enhance competition and ensure efficient performance by air carriers. 2/ Since the sunset of the CAB, we have participated at DOT in merger and other proceedings. 3/

Finally, on January 1, 1989, with expiration of the Department of Transportation's authority over mergers, acquisitions, and intercarrier agreements concerning domestic air transportation, airlines became subject to essentially the same antitrust rules that govern other American industries. 4/ Therefore, airline mergers that violate Section 7 of the Clayton Act 5/ or Sections 1 or 2 of the Sherman Act 6/ now

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2/ E.g., Investigation Into the Competitive Marketing of Air Transportation, CAB Dkt. No. 36595; Notice of Proposed Rulemaking--Carrier-Owned Computer Reservation Systems, CAB Dkt. No. 41686.

3/ E.g., NWA-Republic Acquisition Case, DOT Dkt. No. 43754; Application of American Airlines for Discussion Authority with Antitrust Immunity, DOT Dkt. No. 45333; Application of Pan American World Airways (Aeroflot Agreement), DOT Dkt. No. 45166.

4/ DOT approval is still necessary for the certificates of public convenience and necessity required to fly international routes. See § 401 of the Federal Aviation Act, 49 U.S.C. § 1371. In addition, transfers between carriers of international route authority must be approved by DOT. However, DOT has stated that it will "consider the policy implications of proposed certificate transfers without respect to antitrust considerations, those matters properly belonging to the Department of Justice." Application of Federal Express Company and The Flying Tiger Line, Inc., Order 89-5-10 (May 2, 1989).

5/ 15 U.S.C. § 18.

6/ 15 U.S.C. §§ 1, 2.

will be challenged in the courts by the Department of Justice. 7/ The antitrust analysis that the Division has applied and will continue to apply to merger transactions focuses solely on the likely effects of a transaction on competition in properly defined relevant markets. Thus, as in other industries, the central issue is whether the merger will result in increased prices to consumers by creating, enhancing, or facilitating the exercise of market power by the resulting firms.

As a result of the new legal scheme, airline mergers and acquisitions now must be reported under the premerger notification provisions of Hart-Scott-Rodino ("H-S-R") Act. 8/ Under H-S-R, proposed mergers and acquisitions may not be consummated until 30 days after notification to the Antitrust

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7/ Pursuant to Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45(s)(2), the FTC does not have jurisdiction over transactions involving air carriers subject to the Federal Aviation Act of 1958. Because this restriction survived the sunset of DOT's regulatory authority, government review of airline mergers will fall exclusively on the Antitrust Division. Private parties, however, may now also sue to enjoin airline mergers.

8/ 15 U.S.C. § 18a. Airline mergers were formerly exempt from the reporting provisions of the H-S-R Act as transactions requiring the approval of a regulatory agency. See 16 C.F.R. § 802(b)(1). Because acquisitions by airlines of assets like gates, slots, and aircraft were never subject to DOT review under Section 408, however, they have always been subject to the H-S-R procedures.

Division and the FTC. 9/ This notification assures us an opportunity to review competitively significant transactions before their consummation. If we need additional information to complete our investigation, we can issue a "second-request" letter, and the parties must wait an additional 20 days after complying with our request before they can complete the transaction. 10/

Because the Department's work in the airline industry has been most extensive in connection with our review of proposed mergers and acquisitions, I would like to focus my remarks today on that area of antitrust enforcement. In analyzing the likely competitive effects of airline mergers and acquisitions, we use the principles set forth in the Department's 1984 Merger Guidelines. The Merger Guidelines provide a consistent and

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9/ The H-S-R Act requires parties to transactions that meet certain size thresholds to notify the Department of Justice and the Federal Trade Commission of their plans, to provide the agencies with certain information concerning the merger, and to wait a specified time before consummating the transaction. Basically, the H-S-R Act requires the reporting of transactions transferring in excess of $15 million in assets or voting securities where one of the parties has annual net sales or total assets of $10 million or more and the other has annual net sales or total assets of $100 million or more. 15 U.S.C. § 18a(a).

10/ 15 U.S.C. §§ 18a(b)(1), (e). In the case of cash tender offers, the waiting periods are 15 days, plus an additional 10 days after compliance with a second request letter, if one is sent. *Id*.

rational framework to determine whether the transaction is likely significantly to reduce competition in any line of commerce in any section of the country within the meaning of Section 7 of the Clayton Act. The starting point for any merger analysis under those Guidelines is identifying the relevant markets in which the merging firms compete -- and identifying the firms that compete in those markets. Thus, our analysis of relevant airline markets begins by focusing on individual city-pair routes on which the merging carriers compete, or are among few potential competitors.

If, as is often the case, travelers confronted with a significant non-transitory increase in the fares on a city-pair route would be unlikely to switch to alternative means of transportation (train, bus, car), then scheduled passenger airline service would be the relevant product market. By the same token, if air travelers on a given city-pair route would be unlikely to take a flight to or from a different city when faced with that same increase, then that city-pair would be a relevant geographic market for antitrust purposes.

While relevant airline markets are generally no larger than city-pair routes, they may be narrower. For many air travelers not all flights on a given city-pair route would be viewed as adequate substitutes for each other. Depending on the traveler's time-sensitivity, for example, he or she might not switch to a one- or two-stop flight if the fares on all nonstop flights on the city-pair route were increased significantly. 11/ Similarly, while some travelers may be indifferent as to which of several airports in a city they use, others might not switch to a flight using an alternative airport even if the fares on flights using the most convenient airport were increased significantly. As a result, there will often be instances in which the relevant market is limited to the nonstop flights between two cities, or to the flights using a specific airport in a large city.

In airline markets where a merger leaves few significant remaining carriers, our initial presumption is that there is a competitive problem. If the merger produces a carrier with a dominant market share, or results in high concentration in the market, the remaining firms may be able to participate in the exercise of market power. The presumption that increased

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11/ Certain facts are particulary probative in determining whether nonstop service on a particular city-pair route comprises a relevant market. Chief among these factors are: the duration of the flight, with one-stop service more likely to be an adequate alternative to nonstop service on long flights; the nature of the destination, notably whether there are likely to be a significant number of business travelers who tend to be more time-sensitive and less price-sensitive; and the percentage of connecting passengers traveling between a city pair prior to the merger. See Exception of the Department of Justice to the Recommended Decision of the Administrative Law Judge in TWA-Ozark Acquisition Case, DOT Dkt. No. 43837, at 8-19 (filed Aug. 21, 1986).

concentration will lead to a competitive problem is rebuttable, however, by clear evidence that other factors exist that will frustrate the ability of the few remaining firms to increase prices in the market.

Perhaps the most significant factor is ease of entry by carriers not currently offering competing service between the two cities, or ease of significant expansion of service by airlines currently providing infrequent service to that city pair. If entry or expansion is easy, incumbent carriers that attempt to exercise market power by charging supracompetitive prices will face new supply from firms that will drive prices back down to competitive levels. The Division will conclude that entry is sufficiently easy _only_ if we are persuaded that actual entry on a scale sufficient to overcome or deter a supracompetitive price increase _would_ occur within a two-year period. _12_/

Our airline merger investigations in the past five years have led us to conclude that entry into airline city-pair markets is generally not nearly as easy as had previously been thought. When the Airline Deregulation Act was enacted, it was widely believed that airline markets were "contestable."

_12_/ _See_ Merger Guidelines § 3.3.

Contestable markets are those in which nonincumbent firms can engage in "hit-and-run" entry, successfully meeting or beating the incumbent's fares without incurring any sunk costs that cannot be recouped if and when the entrants exit the market. In theory, contestable markets should perform competitively even where there is only one firm currently providing the service, because the threat of future entry should be strong enough to force that firm to charge competitive prices. In 1978, airline markets were believed to be contestable because service patterns were largely linear, airport space was available, and the airlines' principal assets, their planes, could rapidly be redeployed from one city-pair market to another in response to a change in relative fares. It was also believed that there would be few if any non-recoverable sunk costs that a "hit-and-run" airline would have to incur. In addition, many observers believed that incumbents could not effectively deter such entry.

Today, however, most airline markets do not appear to be contestable. Ironically, this is largely because deregulation has allowed airlines to develop new, and often more efficient means of operation. Deregulation encouraged and enabled carriers to adopt more efficient route structures - basically the "hub-and-spoke" systems that are now so prevalent. In addition, airlines have developed new marketing techniques -- including computer reservation systems, code-sharing, frequent flyer programs and commission overrides -- to inform the public about their service and to develop goodwill and loyalty. Finally, the deregulated environment has allowed airlines to become increasingly sophisticated in their pricing. Through the use of computer reservation systems ("CRSs") and yield-management technology, airlines can quickly, almost instantaneously, respond to changes in demand and supply on each of their routes.

While all of these developments have made "hit-and-run" entry less likely than previously thought, they also likely have increased the efficiency of incumbent carriers. Thus, although these developments necessitate closer scrutiny of airline mergers and acquisitions, they have generally produced positive results for the industry and for the flying public. Load factors have increased, scale economies have been realized, city-pair routes that generate less traffic are being served without subsidies, and travelers, particularly those willing to make their plans in advance, are the beneficiaries of generally lower fares. Thus, while airline deregulation has resulted in significant overall benefits for air travellers, vigorous enforcement of the antitrust laws remains critical to ensuring that those travellers are not threatened by significant harm to free-market competition.

In assessing the likelihood of entry, it is important to recognize that these dramatic improvements in efficiency require time and money to achieve -- for example, the costs of developing a hub, promoting service in new markets, and acquiring and improving gates and slots. Such investments cannot be recouped immediately or necessarily in full if and when the entrant decides to exit. Moreover, the restructuring of airline markets that the development of hub-and-spoke networks has wrought has increased minimum efficient scale on many routes. In the absence of a hub in a particular city or region, it simply may be impossible to achieve the minimum efficient scale on a particular city-pair route that is necessary to compete with the incumbents.

Code-sharing is another hub-related practice that has developed under airline deregulation. 13/ As with other aspects of hubbing, code-sharing can be a prerequisite for

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13/ Code-sharing generally refers to the practice of a trunk airline and a commuter airline jointly marketing connecting service. The commuter carrier will be identified in computer reservation systems and the Official Airline Guide by the airline code of the trunk, in effect creating on-line service between cities served by the commuter and cities served by the trunk carrier. The usual practice involves the commuter airline code-sharing exclusively with one trunk carrier at the airport, and vice versa. These relationships normally benefit consumers by creating on-line service and convenient connections where they might otherwise not exist. The practice is a form of vertical integration between trunk and commuter airlines, but without common ownership.

successful entry in many airline markets. The existence of an exclusive code-sharing relationship between an incumbent hub carrier and a commuter airline at the same hub raises the same issues raised by hubbing in general. Code-sharing may enhance competition over alternate hubs on some one-stop city pairs, but there may be little or no competition for commuter service to and from the hub. Thus, the dominant commuter may achieve a market position on commuter routes similar to that possessed by its code-sharing hub carrier.

A trunk carrier seeking to build a new hub at an airport with an incumbent trunk and affiliated commuter, may, in order to match the efficiency of the incumbent, need to enter on a scale and configuration that enables it to capture comparable feed traffic. Establishing its own code-sharing relationship with a commuter airline is one method by which a carrier can obtain feed traffic. By the same token, a potential commuter airline entrant may need to establish an affiliation with a hubbing trunk carrier in order to obtain feeder through-traffic for passengers traveling between its destinations and the hub.

Code-sharing as such has helped improve service, frequency and reliability by creating new on-line service, and as such represents a benefit to consumers. Thus, code-sharing can be efficiency-enhancing, and should not be prohibited. Code-sharing may, however, make new entry at a hub more difficult because it increases the scale at which a new carrier must enter in order to be as efficient as the incumbent.

During the last ten years, the airline mergers that raised the most serious competitive concerns for the Department have involved airlines that had major hubs at the same airport. In particular, the mergers of TWA and Ozark, both of which had major hubs in St. Louis, and of Northwest and Republic, which both had hubs at Minneapolis/St. Paul, raised sufficient competitive concerns that the Department of Justice objected to their approval by the Department of Transportation. 14/ In both cases, the merging carriers were the only airlines providing nonstop service between the hub city and smaller cities in the surrounding region -- cities like Bismarck, North Dakota, and Cedar Rapids, Iowa, which do not generate a large volume of traffic. For those city-pair routes, we concluded that only a hub carrier could generate sufficient traffic to achieve minimum efficient scale and that any non-hubbing carrier that attempted to enter those markets would be at a

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14/ See Amended Post-Hearing Brief of the Department of Justice, Northwest-Republic Acquisition Case, DOT Dkt. No. 43754 (filed May 28, 1986); Post-Hearing Brief of the Department of Justice, TWA-Ozark Acquisition Case, DOT Dkt. No. 43837 (filed July 14, 1986) (hereinafter "TWA-Ozark Post-Hearing Brief").

significant cost disadvantage with respect to the incumbent carrier. 15/

Moreover, because of the cost and time constraints associated with building new hubs, and because the merging carriers controlled the gates that a new entrant would need to build a hub, we also concluded it unlikely that another airline would build a hub at St. Louis or at Minneapolis/St. Paul within two years after those respective mergers occurred. Specifically, we determined that entry by another hub carrier at St. Louis would not occur unless the merging airlines divested at least ten gates. 16/ The Department of Transportation disagreed with our position in both of these cases, however, and approved the mergers. 17/

Thus, our experience with the TWA/Ozark and Northwest/Republic overlapping hub mergers indicates that, in those situations, rivals are unable profitably to establish equivalent service in response to an anticompetitive price

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15/ Notably, the merging parties did not argue that St. Louis or Minneapolis/St. Paul generated enough traffic to support only one hub carrier in those markets.

16/ TWA-Ozark Post-Hearing Brief, *supra* note 14, at 5.

17/ TWA-Ozark Acquisition Case, DOT Dkt. No. 43837, Order No. 86-9-29 (Sept. 15, 1986); Northwest-Republic Acquisition Case, DOT Dkt. No. 43754, Order No. 86-7-81 (July 31, 1986).

increase or service deterioration in a reasonable period of time. Unless the contrary is shown in a particular case, and in the absence of unusual circumstances, 18/ the Department of Justice will seek to prevent mergers between airlines with overlapping hubs. As I will more fully discuss, two post-sunset transactions that received close scrutiny from the Department of Justice since January 1, 1989 -- Britt Airways' sale of commuter slots at Chicago's O'Hare Airport to American, and Eastern's sale of gates at Philadelphia International Airport to USAir -- were of concern to us because both transactions implicated the loss of a potential hub operator.

The development of computer reservations systems in the last ten years has also made "hit-and-run" entry more difficult. Our investigation earlier this year of the proposed CRS joint venture between American Airlines' Sabre and Delta's Datas II confirmed that, despite the existence of DOT's rules against carriers biasing their CRS systems to favor their own

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18/ A merger, for example, may present a "failing firm" defense that will permit an otherwise anticompetitive merger to pass muster under the antitrust laws. Merger Guidelines § 5.1. Despite the fact that the proposed acquisition by Texas Air of People Express (which owned Frontier Airline's assets) combined the operations of two airlines using Denver as a hub, it was not challenged under the antitrust laws because People Express would have failed in the absence of the merger and there was no less anticompetitive purchaser of People's assets, the two requirements for establishing the "failing firm" defense.

flights, CRS systems do give their owners an advantage in obtaining bookings for their own flights. Our analysis of the effect a CRS can have on entry in airline passenger markets led us to conclude that the proposed merger of Sabre and Datas would make airline entry on numerous city pairs significantly more difficult to achieve.

When an incumbent airline also owns a dominant CRS on a city pair, that airline receives substantial "incremental revenues," that is, a disproportionate number of bookings in that market made by travel agents using its CRS. The higher the airline and CRS shares an incumbent possesses on a city pair, the greater are the incremental revenues, and the more difficult it is for other airlines to enter. The proposed CRS merger would have increased substantially the number of city pairs in which American and Delta had large CRS shares and large airline shares. In large part because of the adverse effect on entry conditions, and hence competition, on these city pairs, the Department announced it would challenge the merger if the parties chose to proceed. Secretary of Transportation Skinner reached a similar conclusion, which he conveyed to the Department, that the American/Delta CRS merger posed a threat to competition. Following our announcement, the parties abandoned the transaction.

Second, but no less important in decreasing the prospects of "hit-and-run" entry, CRSs and other yield-management technology enable airlines to engage in real-time seat management. Yield management systems allow carriers to open and close various fare categories frequently as flight time approaches depending upon the demand for seats on the flight. Thus, a low fare that was available yesterday may not be available tomorrow, and vice versa. That capability means that incumbents can instantaneously and selectively respond to new entrants by modifying existing fare and other service options.

It is well known that passengers flying on the same aircraft may be paying widely different fares for that transportation. There is nothing inherently anticompetitive about these types of differential prices for airline travel; to the contrary, such pricing enables airlines to increase output by offering lower fares to marginal passengers that might not otherwise fly. Nevertheless, the existence of price discrimination can be relevant to an antitrust analysis in several respects. In the least, the ability of incumbent airlines to respond selectively to new competition can make new entry less likely. On the other hand, price discrimination might indicate a predatory strategy adopted by a carrier that was attempting to monopolize an airline market.

It is important to remember in this context that the efficiencies created by hubbing give an incumbent hub carrier lower costs, which is why the Department views entry with a hub to be necessary in many markets. It is therefore to be expected that a hub carrier can reduce its fares on spoke city-pairs below the level of a new entrant that has not yet developed an equally efficient hub. Since lower prices generally benefit consumers, it is important to distinguish between fare reductions that constitute so-called "hard competition" and those that have the potential to harm competition through the exercise of market power.

The Department will treat predation in the airline industry no differently from predation in any other industry. In general, unlawful predation involves a firm with a large or dominant market share which sells below its own costs in an attempt to drive its rivals from the market in the hopes of recouping its losses at some later date by raising prices above competitive levels -- assuming entry barriers or other market conditions would permit such exercise of market power. Where airlines use predatory tactics to monopolize or attempt to monopolize, the Department will investigate and, if appropriate, commence an enforcement action under Section 2 of the Sherman Act. Currently, we have one on-going investigation in the airline industry that involves allegations of predatory conduct, including predatory pricing.

There are also key factors that make "hit-and-run" entry difficult that are unrelated to improved operating efficiency of airlines -- constraints caused by the failure of the air system infrastructure to keep pace with the growth in air traffic. Despite increasing traffic, I understand that no major airport has been built since 1974 and that gate space at airports has not always been expanded adequately or efficiently. In addition, congestion at four of the nation's busiest airports has resulted in the necessity of granting takeoff and landing rights (slots). Unless a carrier can obtain these assets, which is difficult with a scarce supply of such assets controlled by dominant incumbents, entry is simply impossible. Thus, any analysis of competition in airline markets inevitably involves an analysis of access to the airport facilities that are necessary to provide service on a city pair.

If gates, landing rights, or other facilities at an airport are constrained or in short supply, fares will be higher, service levels will be lower, and entry by new carriers will be impeded. When physical constraints to airport access exist, however, it enhances competition and economic efficiency for those scarce resources to be allocated in an efficient manner. This was the intent of the FAA's "buy-sell" rule. 19/

19/ 14 C.F.R. 93, Subpart K.

Efficient allocation usually means that airlines should be free to buy and sell such facilities, and that carriers should not be permitted to interfere with the efforts of their competitors to do so.

Like any other transaction involving transfer of valuable assets between competitors, the Antitrust Division will carefully scrutinize transactions involving scarce airport facilities to determine if the transaction might have anticompetitive effects. Incumbent airlines clearly have an incentive to impede the ability of new competitors easily to gain access to airports that the incumbents serve. For example, majority-in-interest clauses, whereby a majority of incumbent carriers at an airport must approve any sizable expansion or improvement of facilities, could be used by incumbents in this manner at a constrained airport. 20/ Thus, their competitive effects must be determined on a case-by-case basis.

20/ Such clauses, or their exercise, are not inevitably anticompetitive, however, as carriers that finance airport improvements have a legitimate interest in exercising some measure of control over how their funds are spent and protecting the value of their investment. To the extent that the clauses provide this control, carriers can reduce the risk of investment in airport facilities, and thus are more likely to make those investments. This benefits the traveling public. Where, on the other hand, current tenants are not financing the expansion, there is little justification for such clauses.

Similarly, transactions in slots might produce anticompetitive results. In particular, the highest price for slots might be offered by the carriers that will make most efficient use of them, or, alternatively, the most anticompetitive use of them. When Britt Airways attempted to sell its commuter slots to American Airlines, one of two hub carriers at O'Hare, the Department investigated to determine whether the sale of those slots to a major competitor at O'Hare was anticompetitive. The Department concluded that Britt would be unable to survive as an independent commuter carrier at O'Hare because its parent, Continental, did not have a hub at O'Hare. However, no less anticompetitive purchaser was interested in buying the Britt slots. Accordingly, we determined not to challenge that transaction. The Department will, however, continue to monitor slot transfers and investigate where a slot acquisition potentially violates the antitrust laws. The Department is currently conducting one such investigation.

Scarce assets were also at issue earlier this year when Eastern proposed to sell gates and other assets at Philadelphia International Airport (PHL), as well as international route authority between PHL and Toronto, Canada, to USAir, its major competitor at PHL. Our investigation of that proposed transaction led us to conclude that it would violate the antitrust laws. We found that a significant block of gates is needed to operate a hub at an airport, and that Eastern's contiguous block of ten gates at PHL could not be duplicated by another carrier within a reasonable period of time. Thus, by purchasing Eastern's block of contiguous gates at PHL, USAir would prevent that unique asset from being available to competitors seeking to establish a competing hub. Accordingly, the Department announced that it had concluded that the proposed transaction threatened significantly to lessen competition in the provision of airline passenger service between Philadelphia and other cities, in violation of the antitrust laws. The Department of Transportation conducted its own analysis of this transaction and expressed its view that it posed a threat to competition.

Subsequent to our announcement, Eastern withdrew from its proposed transaction with USAir, and reached agreement with Midway Airlines that Midway would purchase Eastern's entire block of ten gates at PHL, as well as the Canadian routes and other assets. As a result, it now appears that the traveling public will receive the benefits of airline competition provided by a second hub carrier at Philadelphia. The Department is closely monitoring the Eastern bankruptcy proceedings and you may be assured that all dispositions of Eastern's assets will be closely scrutinized -- as this one was -- to determine whether they are likely to harm airline competition. If necessary, the Department will request that the bankruptcy court withhold action with respect to any such proposed disposition in order to permit that review.

Some of the other airline mergers and acquisitions that also raised competitive concerns are more likely to be replicated in the future. For example, we may see mergers or acquisitions like USAir's proposed acquisition of Eastern's Philadelphia-Toronto route. That transaction involved the acquisition of an international route by an airline that already had authority to provide competing international service. In such a case, if concentration is very high and entry by new carriers or the addition of capacity by existing carriers is precluded by international agreement, then the Department is likely to object to the transfer of route authority, as we did in the USAir-Eastern case. 21/ I hope,

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21/ We announced that we would sue to block the sale of Eastern's Philadelphia-Toronto non-stop route authority to USAir. Entry on Canadian routes is limited by our bilateral agreement with Canada, which limits non-stop service on Philadelphia-Toronto to one carrier. Eastern carried most of the Philadelphia-Toronto traffic on its non-stop route, and USAir was the only significant competitive constraint on Eastern with several one-stop (same plane) flights over three gateways. The two carriers combined carried virtually all of the traffic. The transfer thus would have given USAir virtually all Philadelphia-Toronto traffic.

The Department also opposed United's acquisition of Pan American's Pacific Division on a similar basis; entry into the routes in question was limited by a bilateral agreement between the U.S. and Japanese governments. Post-Hearing Brief of the United States Department of Justice, Pacific Division Transfer Case, DOT Dkt. No. 43065 (filed Sept. 16, 1985).

however, that liberalization of international air service agreements will continue and that the International Air Transport Association's ("IATA's") ability to operate international airline cartels will decline further. If so, there will be greater opportunities for entry on international routes and so a reduced need for antitrust objections to such international mergers and acquisitions.

Recently, there has been increased interest in the antitrust implications of transactions between foreign and domestic carriers. Mergers between foreign and domestic firms are not new to the antitrust laws or to the Department of Justice, although we do not anticipate outright mergers involving foreign and domestic firms in the airline industry. Ownership of domestic carriers by foreign nationals is limited by law to 25 percent (49 U.S.C. § 1301(16)), and foreign countries often have similar laws or policies that restrict foreign ownership of their national carriers. More likely is the formation of marketing joint ventures, with or without cross-ownership interests, involving foreign and domestic airlines, particularly for interline travel on the joint-venturing carriers. 22/ These types of transactions, or

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22/ The recent joint-marketing/code-sharing agreement between Continental and SAS is an example. In that case, SAS also bought 9.9 percent of Continental, and the carriers provide

Footnote Continued

any consolidation between foreign and domestic airlines, would be analyzed under the antitrust laws using the same analysis described in the Department's 1984 Merger Guidelines. In addition, the considerations detailed in several sections of the Department's recently issued Antitrust Enforcement Guidelines for International Operations would apply to the airline industry. 23/

Finally, we look closely at mergers that involve carriers with most of their hubs in a region of the country. The concern with such mergers generally relates to competition on one- or two-stop flights over alternative hubs in a region. In such cases, the alternative one- or two-stop routes between city pairs within that region might all require transfer at hubs controlled by the same carrier or a very small group of carriers, or might require circuitous routing to a hub far outside the region and then back into the region.

22/ Continued

"on-line" international service using Continental's Newark gateway. Joint-marketing arrangements also exist between Pan Am and Aeroflot, American and Quantas, and United and British Air, among others.

23/ See Part I, § 3.3; Part II, cases 1, 3.

A number of factors will be relevant to the Antitrust Division's determination whether a merger among carriers operating hubs within a region would be anticompetitive. Chief among these will be the degree to which passengers on city pairs connected through the merging carriers' hubs have alternative routings that use other hubs operated by other carriers.

In conclusion, our nation's airline industry has gone through tremendous change in recent years. To a large extent, consumers have been the beneficiaries. To preserve and secure the benefits of airline deregulation, the antitrust laws must be enforced vigorously to ensure that consumers are protected against unreasonable restraints of trade and from mergers or other transactions that could lead to the exercise of market power. The Department of Justice intends to use its new authority -- as well as its pre-existing authority -- to enforce those laws vigorously and to promote and protect free market competition in the airline industry.

Mr. Chairman, that concludes my prepared remarks. I would be happy to answer any questions that you or other members of the Subcommittee may have.

Answers to Questions from Senator Ford

Question:

1. Overall, do you think there are adequate levels of competition in the airline industry today? If so, please discuss those industry characteristics that lead you to that conclusion.

Answer:

The Department believes that, as a result of deregulation, the flying public now enjoys a much greater level of service, and at lower fares. These improvements are a direct result of the increased competition that deregulation has brought about. Empirical studies have consistently shown that, overall, the flying public is much better off under deregulation. For example, a 1986 study estimated an annual benefit to consumers of $5.7 billion as a result of deregulation. See Steven Morrison and Clifford Winston, The Economic Effects of Airline Deregulation, The Brookings Institute (1986).

That is not to say that structural or behavioral problems will not arise in the airline industry, as they do in all major industries. Some initial competitive problems are to be expected as an industry makes the transition from heavily regulated to deregulated, and it should not be assumed that those problems will continue indefinitely. For example, the efficiencies created by hub-and-spoke systems that have made increased service on larger aircraft possible for most cities also mean that a non-hub carrier will have difficulty competing with a more efficient hub carrier on nonstop spoke routes. Some city pairs, particularly short hauls involving smaller communities, may have but one carrier, usually the carrier with the closest hub, providing service. This is often because the smaller volumes of traffic do not justify competing service.

Increased airline competition should result in the long run as the rigors of the marketplace force carriers to become as efficient as possible, from a continuing growth in demand, and from the development of new, more efficient aircraft. It is important therefore, for the long-run competitive vitality of the industry to assure that market forces are permitted to work, undiminished by private restraints. Thus, the appropriate solution to competitive problems is vigorous antitrust enforcement. In addition, DOT has authority under section 411 of the Federal Aviation Act to prohibit unfair or deceptive practices where they may occur.

Question:

2. You refer to "hit-and-run" entry as the competitive threat that will hold down fares in the airline industry. In your view, is that type of entry still possible today?

Answer:

The Department does not view "hit-and-run" entry as a competitive threat that alone will hold down fares in the airline industry. The concept of "hit-and-run" entry is closely associated with the theory of contestable markets. While that theory had frequently been said to apply to the airline industry, the Department does not believe that it does. The theoretical conditions for perfect contestability are that: (1) an entrant incur no sunk costs of entry; (2) an entrant be able to begin serving before an incumbent can change its price; and (3) an entrant have the same post-entry costs as incumbents. The first two of these conditions are not satisfied in the airline industry. Entry into a city pair entails some degree of unrecoverable investment; it may or may not be substantial, but it certainly does exist. Moreover, there is some lead time in starting a new route, but prices on an existing route can be changed instantly; thus, incumbents can react to entry before the new service has begun. For these reasons, the predicted outcome of the theory -- competitive performance with any number of incumbent firms -- cannot be expected in the airline industry.

Despite the fact that airline markets are not perfectly contestable, the Department believes that the threat of entry is an important competitive force in the airline industry that can affect the performance of market incumbents in certain situations. The fact that the first two conditions for perfect contestability are not met does not appear to prevent established carriers from having a competitive effect on city pairs they are poised to enter at costs at or below the level of incumbents. On many city pairs a potential entrant would not be at a cost disadvantage and so the threat of entry has a significant effect. City pairs on which potential entrants would be at a significant cost disadvantage generally are nonstop city pairs out of hubs at which the hubbing carriers have a significant advantage in feed traffic over potential entrants. By contrast, a carrier with a convenient hub could start one-stop service on spoke city pairs over its hub in competition with carriers providing one-stop service over alternative hubs, and not be at a significant cost disadvantage.

Research done by Antitrust Division economists has indicated that airline fares are best explained not by the theory of contestability, but by a measure of concentration that incorporates both the actual competitors in a market and the number of potential entrants that would not be at a significant cost disadvantage. These potential entrants are, loosely speaking, those carriers not serving, but with a hub at an endpoint in, the market. See Gloria J. Hurdle, Richard L. Johnson, Andrew S. Joskow, Gregory J. Werden, Michael A. Williams, "Concentration, Potential Entry, and Performance in the Airline Industry," Economic Analysis Group Discussion Paper 88-3, February 19, 1988. A copy is enclosed for the Subcommittee's information.

A more recent study confirms that the loss of an actual competitor can be harmful: "The merger of TWA and Ozark appears to have caused a slight increase in fares and a far greater reduction in service on city pairs out of St. Louis. The merger of Northwest and Republic appears to have caused a significant increase in fares and a significant reduction in overall service on city pairs out of Minneapolis-St. Paul, but to have significantly increased the number of cities served." Gregory J. Werden, Andrew S. Joskow, and Richard L. Johnson, "The Effects of Mergers on Economic Performance: Two Case Studies from the Airline Industry," Economic Analysis Group Discussion Paper 89-15, October 2, 1989. A copy is also enclosed.

PREDATORY PRICING

Question:

3. In your statement, you indicated that the Justice Department has one on-going investigation in the airline industry that involves allegations of predatory conduct. Can you give us any details of this investigation?

Answer:

We are investigating the possible use of predatory pricing as well as other potentially exclusionary conduct in a number of discrete markets. We cannot give further details of the investigation at this time.

EASTERN AIR LINES

Question:

4. You stated that, if necessary, the Justice Department will intervene with the Bankruptcy Court, requesting that it withhold action on the proposed disposition of Eastern Airlines' assets. Under what circumstances would you take such action and how?

Answer:

If necessary, we would take action very similar to that which we took with regard to Eastern's proposed sale of gates at Philadelphia International Airport and Canadian routes to USAir. In that case, Eastern had proposed the sale and had asked the bankruptcy court to approve it pursuant to statutory procedures. Although the Hart-Scott-Rodino Act requires that reportable transactions subject to the jurisdiction of the bankruptcy court must be filed, the normal waiting periods do not apply. In the case of the Philadelphia assets, we asked the Bankruptcy Court to withhold approval, thereby assuring that a transaction that appeared to raise competitive concerns would not be consummated until we had time to conduct our investigation to determine the transaction's legality under the antitrust laws. If in the future Eastern proposes to sell additional assets, or the airline as a whole, we would take similar action to the extent necessary to assure that we have an adequate opportunity to review the transaction.

In addition, if the bankruptcy court had before it alternative proposals, both legal under the antitrust laws but one clearly more procompetitive, we would consider making our views known to the bankruptcy court, so that the court was fully aware of the important competitive implications of choosing one alternative over another.

COMPUTER RESERVATION SYSTEMS

Question:

5. Earlier today, the General Accounting Office stated that computer reservation systems appear to have a clear anticompetitive effect. What is your reaction to that claim? What remedies would you suggest be undertaken to resolve that conclusion?

Answer:

The Department's investigation of the proposed joint venture between American Airlines' Sabre system and Delta Airline's Datas II system revealed that computerized reservation systems (CRSs) can have anticompetitive effects. For example, a carrier with the dominant CRS in a city will tend to get a disproportionately large share of the bookings in that city. That will place other airlines at a competitive disadvantage in airline city-pair markets involving that city and make entry into those markets more difficult. We concluded that the proposed merger of these two CRSs would exacerbate these competitive problems, and the transaction was abandoned after we announced our opposition to it. The Department is currently studying what should be done about the competitive problems that exist in the CRS industry apart from proposed consolidations. We plan to make recommendations to the Department of Transportation in the context of the Advance Notice of Proposed Rulemaking on computerized reservation systems recently issued by DOT.

MARKET ALLOCATION

Question:

6. You mentioned that the buying and selling of facilities among the airlines is the most efficient means of allocation. Given the difficulties experienced with the Buy-Sell Rule, would this philosophy apply to airport slots at the four High Density airports? If Congress were to consider alternatives to your preferred approach, what would you suggest?

Answer:

The Department strongly believes that carriers should be able to buy and sell slots as part of any slot allocation system. Slots will go to the highest valued use if carriers are allowed to buy and sell them. One possible alternative to the present rule is that slots not be reserved as commuter slots, but rather that all slots be usable by air carriers or by commuter carriers, whichever is willing to pay the most for their use. In any event, the allocation of slots will be more efficient the more that market forces can be used to determine their allocation.

INTERNATIONAL INVESTMENT

Question:

7. At the hearing, you stated that the Justice Department would have a "large input" into the review of airline acquisitions in which foreign entities are involved. Then, in a follow-up question, you said that you had not been involved in the on-going review of the acquisition of Northwest Airlines by Wings Holding, Inc., in which there is a significant foreign involvement. Could you please clarify the Department's role in this area?

Answer:

The Antitrust Division did indeed closely review the acquisition of Northwest by Wings Holding, Inc. Our review was limited to whether the acquisition would violate the antitrust laws. In this case, the fact that KLM Airlines was an equity partner in Wings created the potential that the transaction could have anticompetitive consequences. Although foreign ownership of domestic carriers is limited by law to 25 percent, even a stake of that size in a competing airline can lead to reduced competition because of reduced financial incentives by the carriers to compete against each other. Our investigation of the transaction revealed that Northwest and KLM are not significant competitors on any international routes involving the United States. Consequently, the investigation was routinely closed, and therefore did not require the personal involvement of the Assistant Attorney General.

Answers to Questions from Senator Danforth

CONCENTRATION

Question:

1. A 1987 report, by Julius Maldutis of Solomon Brothers, showed that 40 of the 50 largest airports had Herfindahl-Hirschman Indices (HHIs) of 1800 or above -- one as high as 10,000. The weighted average HHI of the 50 largest airports was 3,531. The Justice Department defines the market as highly concentrated when the HHI is above 1800. What is DOJ's position on this situation and what action does DOJ plan to take?

Answer:

Concentration is most meaningful when measured in relevant antitrust markets. The usual relevant markets in the airline industry are for travel between specific city pairs. There can also be markets for various airport facilities such as gates, and for slots (take-off and landing rights). Airports as such are not relevant markets, but airport concentration can be indicative of concentration on city pairs emanating from the airport, or of airport facilities, and like airports, both relevant city-pair markets and ground facility markets often are highly concentrated.

The antitrust laws do not proscribe the mere existence of high concentration. Concentration in various airline markets, for example, may result from significant economies of scale and scope, which in turn may benefit consumers. The major source of economies of scale are the efficiencies associated with the use of larger aircraft. Economies of scope arise from the use of airline service patterns, such as hub-and-spoke networks, that allow carriers to fill larger aircraft. In the case of hub-and-spoke networks, banks of connecting passengers simultaneously converge, allowing passengers arriving from many origins to share a single plane to a common end-point. The Department will challenge mergers, acquisitions, and other agreements involving airlines or airport facilities that threaten a significant reduction in competition, and will challenge monopolistic conduct by dominant firms.

PREDATORY PRICING

Question:

1. For decades, this country has had a policy against predatory pricing. In your letter, you noted that you currently have one predatory pricing situation under investigation. It appears to be a common practice in the airline industry for large, established carriers to lower their prices to meet new competitors' prices. When the new competitor eventually drops out of the market, the old carrier raised its price back to the pre-competition levels (see Wall Street Journal, Dispatches from the Air-Fare Front, July 11, 1989). What is the DOJ's position on this? Are the antitrust laws sufficient to deal with this problem?

Answer:

The antitrust laws currently prohibit predation (the selling at below some measure of ones's own cost in an attempt to drive rivals from the market and recoup lost prices by later charging supracompetitive prices), and are adequate to protect consumers from economic harm from such activity. However, it is important to bear in mind the distinction between true predation that threatens competition, and intense competition that benefits consumers. The Department will not challenge a price cut by an established carrier merely because it is in response to entry. The antitrust laws do not and should not prohibit such conduct. Cutting price is both the expected and the desired effect from increased competition. To the extent that established carriers enjoy cost advantages, for example, economies of scale and scope, the antitrust laws do not prohibit them from employing their relative advantage in the form of lower prices. The Department's task is to identify those instances of price cutting that reflect predation rather than a cost advantage.

CODE SHARING

Question:

1. The General Accounting Office reports that Computer Reservation Systems give preference to commuter airlines that code share with major airlines over commuter airlines that interline with major airlines. This makes it difficult for a non-code sharing commuter airline to get a sufficient number of passengers from major airlines serving the hub airports. Non-code sharing airlines are at a competitive disadvantage to code sharing airlines. This also discourages entry by new commuter airlines. How does this situation effect competition?

Answer:

Code sharing and a variety of other practices by major carriers in their dealings with commuters appear to have reduced the number of commuter carriers serving major airports. In many cases, major carriers have integrated commuter affiliates into their hubbing operations. Code sharing permits a major carrier to offer to commuter passengers on-line service through a hub to the passenger's final destination. Arrangements with independent commuters tend to be exclusive and thereby reduce competition among commuter carriers to provide service at a hub airport, whether or not there is code sharing. The integration of commuter affiliates into hubbing operations may result in passengers being provided more convenient connections and allow larger, more efficient, and more comfortable aircraft to be used. This integration and the resulting reduction in the number of commuter carriers are not likely to result in higher prices on connecting flights through the hub, but may result in higher prices in some commuter markets to and from the hub. We doubt that an overall ban on exclusive code-sharing relationships would benefit consumers. Moreover, we doubt the effectiveness of such a ban. Major airlines may choose, as they often have, simply to integrate vertically into commuter markets instead of contracting with existing commuter airlines.

Answers to Questions from Senator McCain

APPLICATION OF THE ANTITRUST LAWS

Question:

1. You expressed concern that Section 7 of the Clayton Act, which forbids anticompetitive acquisitions of assets, may not apply to the airline industry. Should this section be amended?

Answer:

To date we have not encountered a situation in the airline industry where we believe our enforcement efforts have been hampered by this possible gap in coverage, namely, the uncertainty as to whether Section 7 applies equally to asset as well as stock acquisitions in the airline industry. We do, however, believe the asset loophole should be closed. In the past, the Department has supported legislation that would remove any doubt that Section 7 of the Clayton Act applies to asset acquisitions in the airline industry, as it does in virtually every other industry. See, e.g., S. 806 (100th Cong., 1st Sess.).

Question:

2. The airline industry is currently exempt from the provision of the FTC Act which allows the FTC to prohibit unfair practices and unfair competition. This exemption was placed into law when the airline industry was regulated. Should this exemption be removed?

Answer:

The airline industry is not exempt from unfair practices regulation. Although the FTC does not have section 5 jurisdiction over airlines, Section 411 of the Federal Aviation Act, which continues to be applicable, bestows jurisdiction on the Department of Transportation to regulate competitive practices in the airline industry in much the same manner as the FTC does in other industries. Indeed, Section 411 is the statutory basis for DOT's CRS rules, 14 CFR Part 255, and the rules governing on-time performance reporting. 14 CFR Part 234.

MERGERS

Question:

1. You indicated that all types of mergers would be scrutinized according to the Justice Department's Merger Guidelines, even non-ownership agreements. The GAO report that was just released, examining entry barriers in the airline industry, indicated that recent acquisitions of slots at O'Hare by American and United increased the Herfindahl-Hirschman Index (HHI) from 2441 to 3003, an increase of 562 points. Industries with HHIs over 1800 on the HHI scale are considered to be highly concentrated, and increases of over 100 points of these industries are usually challenged. Doesn't this indicate a highly concentrated market in the airline industry? Should this be challenged by the Department?

Answer:

The slot transfers at O'Hare are of concern to the Department, and there is an on-going investigation into them. While the Department would challenge a transaction that permitted a single carrier to acquire a slot monopoly, we have not yet determined whether the slot transfers we are investigating are anticompetitive, and we are not prepared at this time to predict what, if any, enforcement action is appropriate. It is important to remember that the concentration standards contained in the Merger Guidelines are starting points for further analysis, and the assessment of the likely competitive effects of any particular transaction requires a full analysis of all the facts and cirumstances surrounding it. Should the Department determine that certain O'Hare slot transfers violate the antitrust laws and that divestiture would be appropriate, the Department would not hesitate to file suit seeking divestiture.

MAJORITY IN INTEREST CLAUSES

Question:

1. You stated that these clauses are not anticompetitive where they encourage investment in airport expansion. Will you challenge these clauses if the airline with this clause in its contract is blocking future airport construction? Would you be more likely to challenge such a clause if there is a shortage of airport facilities, which prevents new entrants from offering service.

Answer:

The Department currently has an open investigation in this area, but it is too early to speculate about its outcome. Any attempts to deny competitors access to airport facilities would have to be closely scrutinized on a case-by-case basis to determine whether the conduct was unlawful within the meaning of the antitrust laws. Although every case is different, we start with the presumption that airport authorities have negotiated long-term lease agreements with their tenants that are no more generous to the tenants than necessary to obtain their investment in the first instance. The antitrust laws do not require that incumbents pay for and provide airport access for their competitors. Thus, as a general proposition, we would be more likely to challenge clauses and conduct that give incumbents an ability to impede new entrants or airport authorities from spending their own money and accepting their own risks than where airport financing and construction is paid for by the incumbents, and where those carriers bear the risk of airport operating losses.

Question:

The latest GAO Report states that out of 55 airports with majority in interest clauses, 8 airports cite those clauses as major impediments to expansion. The airline industry claims capacity is the only problem in the industry. Are you prepared to investigate and challenge these clauses at those 8 or other airports where capacity is constrained in this way?

Answer:

See Answer to Question below.

Question:

Your letter indicated that your Department would be concerned about anticompetitive effects of these clauses where airlines hoard facilities or make them available only at supra-competitive rates. The GAO reported that sublease rates of facilities can be more than 10 percent over the basic lease rate. What do you consider a "supra-competitive" rate, and what are you doing to investigate this area?

Answer:

A supracompetitive lease rate is a lease rate above that which would prevail in a competitive market. The competitive rate may be relatively high where the airport is physically constrained and airlines with facilities are therefore able to extract a scarcity premium in addition to a normal rate of return. In general, we would not be inherently suspicious that sublease rates that were 10 percent higher than basic long-term lease rates at the same airport were at supracompetitive levels.

Question:

Also, leasing airlines sometimes require a subleasing airline to purchase a "handling contract" (the leasing airline requires the sublessee to use the leasing airline's personnel to staff ground operations) which, in some cases, might raise the cost of operating the facilities up to four times what the subleasing airline could operate it. Isn't this an anticompetitive "tying" arrangement, forbidden by the antitrust laws? Have you investigated this area?

Answer:

Under existing legal precedent, a tie-in requires the conditioning of the purchase of one product or service, over which the seller has market power, on the purchase of a separate product or service, with the result that a not insubstantial amount of commerce is restrainted in a district market for the second product or service. The purpose of the tie-in prohibition is to prevent the leveraging of market power in the first market to restrain competition in the second market. Thus, the courts distinguish between attempts to exploit a firm's market power by merely enhancing the price of a particular product or service on the one hand, and attempts to impose restraints on competition in a separate market on the other, only the latter of which constitutes a tie-in. Whether in any particular situation the requirements for a tie-in are present and, if so, whether that tie-in is unlawful, cannot be answered in the abstract, but would require a thorough analysis of the facts and circumstances presented.

The practice of taking part of the compensation for a gate lease in handling contracts instead of lease payments is not necessarily anticompetitive or illegal, however. If an airline has control of scarce airport facilities, it is reasonable to expect that it will allow them to be used only in exchange for substantial compensation. As indicated above, the antitrust laws do not prohibit the owners of scarce resources from merely charging high prices in compensation for their use, so long as they do not attempt unreasonably to restrain competition in a second market. With that limitation, such compensation may take the form of lease payments or other related payments. In either case, eliminating the source of the market power by expanding airport facilities is far superior to attempting to control its exercise.

CODE SHARING

Question:

1. Both your Department and the GAO note the benefits of code sharing, and some consumers prefer this marketing arrangement. However, the possible anti-competitive effects include price fixing and market allocation between the commuter and the hub airline on competing routes, market barriers to entrants in the commuter market, possible entry barriers to code sharing commuters in other markets from the hub airport. Will you investigate these problems?

Answer:

Price fixing and market allocation by competitors are *per se* violations of the antitrust laws, and when we have reason to believe that these activities are going on, a criminal grand jury investigation would be appropriate. In other situations, such as analyzing mergers or other transactions, we take into account the fact that in some markets entry may require achievement of code-sharing relationships between commuter and hubbing carriers. This does not mean that the practice of code sharing is itself inherently illegal, only that the necessity of reaching code-sharing arrangements in order to compete effectively in a market is a factor that must be accounted for in a competitive analysis.

Question:

2. Computer reservation systems have the ability to list all interline flights. Could legislation which would ban code sharing and make interline agreements available to all airlines on a non-discriminatory basis solve these problems?

Answer:

Banning code sharing would undermine the efficiencies which code sharing has brought about, such as coordinated interline schedules and increased competition on one-stop city pairs. Moreover, a ban on code sharing would do nothing to prohibit deliberate antitrust violations, such as price fixing and horizontal market allocations among trunk and commuter carriers. Finally, while it might appear that banning exclusive code sharing arrangements might make it easier for a second commuter to enter a hub airport dominated by a trunk carrier, the likely result would be for the trunk carrier to integrate vertically and purchase the regional carrier, thereby achieving the same result. If vertical integration would not violate the antitrust laws, then a less extensive code-sharing agreement between the same parties would also be legal.

PREDATORY PRICING

Question:

1. In your letter you state that predatory pricing would be hard to find in the airline industry because hub operations create superior efficiencies. It is well known that the highly profitable trunk lines constitute a large percentage of the profits of an airline. It appears that the trunk lines make it possible for an airline to squeeze out competition in the regional market. Do you consider this to be "achieving monopoly through anticompetitive means," as forbidden by the Sherman Act, Section 2?

Answer:

We are aware of no evidence that so-called "trunk lines," that is, the dense long-haul city-pairs, are more or less profitable than shorter regional routes. Indeed, studies by the Department indicate that the shorter-haul nonstop routes (less than 500 miles) to and from hubs have the higher fares. This is not surprising since the denser, long-haul routes are more subject to competition from other carriers, both nonstop and one-stop. Instead, it appears that the efficiencies of hubbing, rather than the existence of profits from other operations, is the key factor that makes it difficult for a non-hubbing carrier to serve regional markets. Taking advantage of hub efficiencies, and therefore charging lower fares or providing better service than a non-hubbing carrier, does not constitute "achieving monopoly through anticompetitive means."

DISCRIMINATORY PRICING

Question:

1. You have stated that discriminatory pricing has increased the airlines' output and has enabled more passengers to fly than at any time in history. I agree with this analysis. However, you also note that, with the availability of CRS, large airlines may be able to target a price-cutting competitor and respond in an anticompetitive way. Do you have any strategies to monitor this? Would you challenge discrimination if it was found?

Answer:

If selective price-cutting to predatory levels constituted actual or attempted monopolization by an incumbent carrier, we would challenge it. The new entrants who are the victims of such exclusionary conduct have every incentive to bring their own antitrust case, or bring the conduct to our attention. Discrimination as such, however, does not violate the antitrust laws. Only if a carrier with market power is utilizing that power to harm competition, for example, by engaging in selective price-cutting intended to drive rivals from the market, would that conduct run afoul of the antitrust laws. Charging lower prices where you face competition than you charge where you face little or no competition does not violate the antitrust laws. Antitrust enforcement policy should not prohibit incumbent airlines from reducing their fares when challenged by new competition so long as actual predation does not occur.

SLOTS

Question:

1. Your statement indicates that the "buy-sell" rule is the most efficient method of allocating slots. You did note that slot sales might be anticompetitive, however, and you investigated the sale of slots at O'Hare by Britt Airways to United, but did not challenge it. The GAO report notes that slot sales have decreased since the "buy-sell," open market plan was initiated, although leasing has become more popular. GAO cites a high figure of 128 slots sold per quarter in 1986, to a low of 20 slots sold per quarter in 1988. Have you analyzed the uneven slot transfer data for 1989? How can this be an efficient allocation system if no slots are changing hands?

Answer

The FAA has not published data on slot transfers since 1988. Information supplied informally indicates that there have been relatively few permanent slot transfers in 1989, but more leasing. The data do not indicate that no slots are changing hands, since they do not indicate the extent of slot-for-slot trades. But even if we assume that there are no such trades, this would cast no doubt on the efficiency of the buy-sell system in allocating slots. The buy-sell rule was initiated in 1986. It facilitated efficient reallocation of slots, and as the GAO found, there were many slots transferred in 1986. Over time the rate of transfers fell, but that most likely is because buy-sell has permitted improved use of allocated slots, so that, over time, there were fewer efficient trades to be made. If we had the optimal slot allocation and conditions were stable, then the efficient number of slot transfers would be zero. The Department is aware of no evidence suggesting that the optimal allocation of slots is changing rapidly and, therefore, has no reason to believe that there should be more slot transfers than there are.

Question:

2. Also, the GAO report that "not a single carrier has been able to establish new service at a slot-controlled airport by using slots bought on the free market." One airline reports that most slot owners will not discuss sales of slots or the asking price is well over $1 million. To me, it appears that the major airlines have become entrenched at these airports and are trying to extract supra competitive prices. Is the Justice Department satisfied with this situation?

Answer:

Recently, Trump Air used purchased slots to start its shuttle between LaGuardia and National -- two slot-controlled airports. In addition, FAA rules do provide certain slot set-asides for new entrants, although this only becomes relevant where the FAA determines that it controls sufficient available slots to conduct a lottery. See 14 CFR § 93.225. If carriers have not started new service with purchased slots, it may be because the service they would have begun is a less valued use of the scarce slots than their current use. It should surprise no one that slots are valuable assets or that the owners of such assets are not willing to give them away. There is nothing wrong with the owner of a scarce asset selling the asset for a market price that reflects the scarcity value of the asset. Part of the problem may be the fact that the initial allocation of slots was by lottery, so that the original holders obtained them for free. Had the government auctioned these assets, the impression that slot holders are unfairly profiting from slot ownership might have been eliminated.

Question:

3. The GAO reports that concentration of slots at O'Hare has far exceeded the Justice Department guidelines on mergers. Do you intend to enforce Justice Department policy on this matter?

Answer:

See Answers to "Concentration," Question 1, from Senator Danforth, and "Mergers," Question 1, from Senator McCain, above.

Senator **Ford**. Let me ask you one question. The five lights just came on.

You stated that your division would review the level of foreign investment in U.S. airline industry. What is your role in relationship to DOT in the evaluation of airline acquisitions which foreign entities are involved? Will you have a large input or will you all be separated?

Mr. **Rill**. I think we will have a large input.

As you know, there is a limitation on foreign investment in U.S. airlines. Our analysis would be much the same as an arrangement between, as it would be, foreign arrangement between domestic airlines, given the 25 percent cap, I think we would look at an acquisition even up to that level to see if there are factors which suggest that there is a limitation on competition.

Senator **Ford**. When the front money is overwhelmingly foreign airlines or the cash involved is all foreign airlines, would that whet your appetite some?

Mr. **Rill**. That would be a factor that we would certainly evaluate to determine the level of control where there might be competition over competing routes.

We would also look at joint ventures with foreign airlines and domestic airlines to determine whether or not particularly where there are competing routes, there might be a substantial lessening of competition.

Senator **Ford**. Have you all been involved in the Checci deal?

Mr. **Rill**. We have been not involved in that deal, Mr. Chairman. I know that DOT has that situation under review. So far as competition policy is concerned, that is not a matter that so far as I know has been under review at the division, certainly not one that has come to my desk.

Senator **Ford**. Thank you, Mr. Rill. You are mighty nice and patient and understanding, and we will send the questions to you.

We look forward to visiting with you in a more relaxed atmosphere.

Mr. **Rill**. We will respond to them promptly and look forward to that too, Mr. Chairman.

Senator **Ford**. You are mighty nice. Thank you.

[Whereupon, at 11:55 a.m., the subcommittee adjourned, subject to the call of the Chair.]

[The following information was subsequently received for the record:]

GREATER
ALBUQUERQUE
CHAMBER OF
COMMERCE

Testimony by George Friberg, Chairman Elect
Greater Albuquerque Chamber of Commerce
U.S. Senate Commerce, Science and Transportation Committee
Subcommittee on Aviation
September 20, 1989

Mr. Chairman, the Greater Albuquerque Chamber of Commerce, in response to a number of complaints from the business community, is seeking a remedy to the high rate structure for this route. We feel the issue is an important one because of its economic impact on both communities. This corridor historically has been heavily used by the business traveler in aerospace, telecommunications, petroleum products, and other high technology businesses.

The high rate structure has several negative effects:

a) It increases the cost of doing business in the Denver/Albuquerque area

b) It may force relocation of some developing businesses and technologies out of this region

c) It directly affects the establishment of new companies. Linkage with high technology centers in Denver is often vital to a new business in Albuquerque.

The cost of travel has escalated greatly during the past four years to the extent that a next-day travel fare is currently $500 roundtrip. Fares from Albuquerque to other regional cities with comparable mileage are:

Dallas	$164
Phoenix	72
Los Angeles	170
Las Vegas	204

Many of our members are avoiding air travel in this corridor or are avoiding attending any events at all in Denver. Yet, load factors are demonstrably above the 60% average. This fare structure affects both businesses with negotiated rates and those with non-negotiated rates. The enclosed letter from US West exemplifies the changes corporations have made in their travel to Denver.

We sincerely hope that your committee's attention to this situation will result in equitable rates for this region and others similarly affected. We would be happy to testify in person at a future hearing, should it be appropriate.

P.O. Box 25100
Albuquerque, NM 87125
(505) 764-3700
FAX 247-9140

Thank you again for your invitation to testify for the September 20 hearing.

Sincerely,

George Friberg

George Friberg, Chairman-Elect
Board of Directors
Greater Albuquerque Chamber of Commerce

U S WEST Communications
P. O. Box 1355, Sta. 1200
Albuquerque, New Mexico 87103-1355
505 765-7500

D. F. (Duffy) Swan
New Mexico Vice President and
Chief Executive Officer

US WEST
COMMUNICATIONS

March 20, 1989

Ms. Ruth Friesen
Education/Business Development Director
Greater Albuquerque Chamber of Commerce
P.O. Box 25100
Albuquerque, New Mexico 87125

Dear Ruth:

I have reviewed the air fare expenses we have incurred for flights between Albuquerque and Denver the past four years. Needless to say, our travel costs have risen substantially during this period of time. In fact, we now forego traveling to Denver from Albuquerque to the degree possible. (For example, though I have some regional responsibilities with U S WEST, I have chosen not to attend certain officer meetings in Denver primarily due to the airline ticket prices. As a substitute, I participate, in a more limited fashion, by conference call. This is not entirely satisfactory, but it does avoid the air fares.)

As our corporation has regionalized, we have greater needs to travel to Denver--our corporate headquarters. This is evident in the following figures:

1985 - 30% of our New Mexico air travel was to and from Denver

1986 - 42% to/from Denver

1987 - 56% to/from Denver

1988 - 54% to/from Denver

In terms of costs for the same period, our Denver-Albuquerque invoices demonstrate the following:

1985 - U S WEST average ticket price was $78.00 (total Albuquerque/Denver costs were $89,646.00)

1986 - average ticket price was $124.00 (total costs were $147,895.00)

1987 - average ticket price was $217.00
(total costs were $319,180.00)

1988 - average ticket price was $307.00
(total costs were $366,724.00)

I should note that the number of segments (i.e., Albuquerque/ Denver round trips) increased from 1,149 in 1985 to 1,470 in 1987. Though our costs increased in 1988, our segments dropped to 1,193--reflecting our efforts to reduce travel to Denver, a practice we will continue in 1989, given the rate levels.

In short, we have the choice of only two carriers between Albuquerque and Denver. One needs only to examine the Albuquerque/Phoenix rates to note the distinct advantage we enjoy traveling to Arizona. (A case in point: I have been to Phoenix three times in the past six weeks and Denver but once since last November.)

I hope this information is helpful. Please let me know if you need additional details.

My best,

Duffy

D.F. (DUFFY) SWAN

DFS/ka